OVERVIEW OF PREVIOUS DEBT PROPOSALS

HEARING

BEFORE THE

JOINT SELECT COMMITTEE ON DEFICIT REDUCTION CONGRESS OF THE UNITED STATES

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

NOVEMBER 1, 2011

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TUESDAY, NOVEMBER 1, 2011

UNITED STATES CONGRESS,
JOINT SELECT COMMITTEE
ON DEFICIT REDUCTION,
Washington, DC.

The committee met, pursuant to call, at 1:37 p.m., in Room 1100, Longworth House Office Building, Hon. Jeb Hensarling [co-chairman of the joint committee] presiding.

Present: Representatives Hensarling, Becerra, Camp, Clyburn, Upton, and Van Hollen.

Senators Murray, Baucus, Kerry, Kyl, Portman, and Toomey.

Chairman HENSARLING. The committee will come to order.

Before I recognize myself for an opening statement, I wish to make a few preliminary remarks.

Number one, I wish to remind all of our guests that the manifestation of approval or disapproval, including the use of signs or placards, is a violation of the rules which govern this committee. The chair wishes to thank our guests in advance for their cooperation in maintaining order and decorum.

This is the fourth hearing of the Joint Select Committee on Deficit Reduction, entitled "Overview of Previous Debt Proposals."

I want to thank our witnesses. First, I wish to thank them for their service to their country, all long-time, storied public officials.

Senator Alan Simpson, who served as a Senator from Wyoming for 18 years, served as chairman of the Veterans Committee, a member of the Finance, Judiciary, and Aging Committee, and obviously the co-chair of President Obama's National Commission on Fiscal Responsibility and Reform.

Additionally, Erskine Bowles, who served as chief of staff to President Bill Clinton and was appointed by President Obama to also co-chair the National Commission on Fiscal Responsibility and Reform.

Senator Pete Domenici, the longest-serving Senator in New Mexico's history, although New Mexico is still a fairly young State; a storied career as chairman of the Budget Committee; serves as a senior fellow at the Bipartisan Policy Center.

Finally, Dr. Alice Rivlin, who was a vice chairman of the Federal Reserve, director of the OMB in the first Clinton administration, and the founding director of the Congressional Budget Office, and served with Senator Domenici on the Bipartisan Policy Center's Task Force for Debt Reduction.

Again, I want to thank each of our witnesses for their work. There are many other fine organizations and think-tanks that have added value to the process. This particular committee chose to hear from these four individuals and these two bodies.

With that, the chair will now yield to himself for an opening statement.

OPENING STATEMENT OF HON. JEB HENSARLING, A U.S. REPRESENTATIVE FROM TEXAS, CO-CHAIRMAN, JOINT SELECT COMMITTEE ON DEFICIT REDUCTION

Chairman HENSARLING. What I do believe we will hear from each of our witnesses is that America at least does indeed face a legitimate debt crisis. Not only are we operating on borrowed money, we are operating on borrowed time as well.

In that vein, I never tire of reminding not only myself but the public and my colleagues that although we have a statutory goal to reduce the growth of the deficit over 10 years by $1.5 trillion, backed up by a $1.2 trillion sequester should we fail, more importantly we have a statutory duty to proffer legislation that would significantly improve the Nation's long-term fiscal imbalance.

What could not be clearer is that unless we offer fundamental and structural reforms to our Nation's entitlement programs, especially health care, we will not only end up failing in our duty, we may fail our Nation as well.

Health-care costs, measured by GDP, roughly have doubled since the time of my birth until I entered the workforce and have risen about two-thirds since then and are growing at what all acknowledge to be an unsustainable rate. Every agency and think-tank that I am aware of, every academic study shows that Medicare will go broke in 9 to 13 years. The President himself has said, "The major driver of our long-term liabilities—everybody here knows it—is Medicare and Medicaid and our health-care spending. Nothing comes close." I continue to agree with the President.

Unfortunately, Social Security faces its problems as well. My children will likely put more money into Social Security than they take out—at best, generational unfairness; at worst, a form of generational theft.

We have previously heard from the Congressional Budget Office that tax revenues, upon the recovery of this economy, will once again produce roughly 18.5 percent of GDP. We also know that there are many tax increases that are already built into current law. But spending, principally driven by our health-care and retirement programs, is due to roughly double in size, to 40 percent of GDP, over the course of a generation from where it was just a few short years ago.

Certainly, we cannot tax our way out of this crisis. We cannot solve it by simply tinkering around the edges of our entitlement programs. For the sake of our economy, our jobs, our National security, and our children's future, many people say it is time to, "go big." I agree, but going big is not merely measured by slowing the rate of growth of the deficit over the next 10 years. Going big must be measured in solving the problem—in other words, fundamental and structural reforms of our entitlement programs, giving every American the opportunity for quality health care and quality retirement security at a cost that does not harm our jobs and diminish our children's future.

[The prepared statement of Chairman Hensarling appears in the appendix.]

With that, I will now yield for an opening statement to my co-chair, Senator Murray of Washington.

OPENING STATEMENT OF HON. PATTY MURRAY, A U.S. SENATOR FROM WASHINGTON, CO-CHAIRMAN, JOINT SELECT COMMITTEE ON DEFICIT REDUCTION

Co-Chair MURRAY. Thank you very much, Co-Chair Hensarling.

And I want to thank all of our colleagues and especially our witnesses who have all come today. We really appreciate your being in front of this committee today. And I want to thank all the members of the public who are joining us, as well.

We have all been working very hard over the past 2 months, but with 23 days left to go until our deadline and with even less time before we need to have a plan ready to be voted on, we are now entering the critical final phase of this process. And, as we all know, the consequences of failure are unacceptable. The triggers that have been put in place would be devastating for our National defense and for middle-class families and the most vulnerable Americans that depend on this country for things like education and housing and even nutrition assistance for women and infants.

Markets, rating agencies, and businesses across the country are watching closely to see if Congress can solve this problem. And the American people are looking to us to break out of the gridlock and partisan rancor that has dominated D.C. recently and to deliver the kinds of results that they expect and they deserve.

That is why members of this committee have been clear: We need to find a way to come together around a bipartisan deal. So I believe it is very appropriate that we are having this hearing with these witnesses as we move into these final few weeks.

Before us we have Democrats and Republicans who were able to come together around big and balanced proposals that tackle some of the most difficult challenges facing our Nation. The two groups went about it in slightly different ways, and I don't agree with each piece of each plan, but they provide serious models for big and balanced bipartisan proposals.

And as I know we will hear more about it today, these proposals achieved bipartisan support and came together only because they were balanced, they included concessions from all sides, and they required all Americans to share in the sacrifices that this endeavor calls for. Neither of these bipartisan proposals included only spending cuts, and they didn't simply address entitlements or only raise revenues. They put everything on the table. They made tough decisions, and because of that, they were able to put together balanced packages that garnered bipartisan support.

So, as this committee moves into the home stretch, hearing more about the importance of a balanced approach is going to be very helpful. As our witnesses today can address, a bipartisan deal isn't possible if Members refuse to come out of their partisan or ideological corners. It is not enough for either side to simply say they want to reduce the deficit. Now is the time when everyone needs to be putting some real skin in the game and offering serious compromises.

Democrats have made clear that we are prepared to do that. We have said we are very open to painful concessions and compromises if Republicans are, as well. And we have put forward serious ideas to reflect that. But these concessions will only be made and only considered in the context of a balanced deal that doesn't just fall on the middle class and most vulnerable Americans. But that requires big corporations and the wealthiest among us to share in the sacrifice.

The American people realize that. They overwhelmingly support a balanced approach, which is why this is the kind of deal every bipartisan group that has successfully tackled this issue has made. It is the kind of solution I am looking forward to hearing more about from our witnesses today, and it is the kind of deal I hope that every member of this committee is prepared to make.

So, again, I want to thank our witnesses for being here with us to have this critical conversation. The bipartisan, balanced plans that you have put forward provide a strong foundation for this committee, and we look forward to hearing your testimony and having a chance to ask our questions. So, again, thank you to all of you for being here today.

[The prepared statement of Co-Chair Murray appears in the appendix.]

Chairman HENSARLING. Thank you, Senator Murray.

And now we will hear from our panel. I have no idea why you are seated in this order, but we are going to start with you, Mr. Bowles.

Each witness will be recognized for 5 minutes, at which time members will have 10 minutes for questions.

Mr. Bowles, we are now prepared to receive your testimony.

STATEMENT OF ERSKINE BOWLES, CO-CHAIR, NATIONAL COMMISSION ON FISCAL RESPONSIBILITY AND REFORM

Mr. BOWLES. Thank you, Mr. Chairman. I am delighted to be here. I am delighted to be in the company of these three great Americans. And I want to thank you for inviting me to come.

Both Alan and I thought long and hard about what we wanted to say today. We have submitted something in writing to you, but, instead, I would like to just speak to you from a few notes I have made.

I know most of you. I have worked closely with almost all of you on both sides of the aisle. I have great respect for each of you individually, but, collectively, I am worried you are going to fail—fail the country.

When Alan and I first got into this, we thought we were doing it for our 15 grandkids. I have nine, and he has six. But the closer we got to the numbers, the more we realized we weren't doing it for our grandkids, we weren't even doing it for our kids; we were doing it for us. That is how dire the situation is today.

I think that we face the most predictable economic crisis in history. I know that the fiscal path we are on here in Washington is not sustainable. And I know that each of you know it and you see it, because it is as clear as day.

When Alan and I travel around the country and we talk to people and we ask them, why do you think we have these deficits, they tell us, oh, it's got to be waste, fraud, and abuse, it's got to be foreign aid, oil company subsidies. And, yes, all of those are a small part of the problem. But the big problem really comes from four sources, and you know it.

The first is health care. We spend twice as much as any developed country in the world on health care. And, unfortunately, if you look at the outcomes, our outcomes don't match the outlays. We rank somewhere between 25th and 50th in things like infant mortality, life expectancy, preventable death. And so the rapid growth of health care and the unsustainable growth of health care is our number-one problem.

The second biggest problem today, I believe, is that we spend in this country more than the next 14 largest countries combined on defense. Admiral Mullen, Chairman of the Joint Chiefs of Staff, who just stepped down, recently said that our biggest national security problem is these deficits and this debt because it will consume every dollar of resource we have. We believe that we have to make reasonable cuts in defense.

Third, I believe that we have the most ineffective, inefficient, anticompetitive tax system that man could dream up. What we believe you need to do is broaden the base, simplify the Code, eliminate or at least greatly reduce this backdoor spending that is in the Tax Code, and use that money to bring down rates and reduce the deficit.

And the fourth cause of the deficit is simply interest on the debt. And if there is one thing I am familiar with, it is the power of compound interest. And when interest rates go back to normal, this country is going to experience the power of compound interest.

This is a problem we can't grow our way out of. We could have double-digit growth for decades and not solve this problem. And, as the chairman said, it is not a problem we can solely tax our way out of. Raising taxes doesn't do a darn thing to change the demographics of a country or change the fact that health care is growing at a faster rate than GDP. And it is also not a problem that we can solely cut our way out of. I think you all have proven that over the last year.

That is why our commission came up with a balanced plan of $4 trillion of deficit reduction over the next decade. We didn't make the $4 trillion number up because the No. 4 bus rode down the street. Four trillion is not the maximum amount we need to reduce the deficit, it is not the ideal amount, it is the minimum amount we need to reduce the deficit in order to stabilize the debt and get it on a downward path as a percent of GDP.

We based this proposal on six basic principles. Those principles are that we shouldn't do anything to disrupt a very fragile economic recovery, so we made very light cuts in 2011 and 2012 and did not get spending back to pre-crisis levels in 2013, when we did get it back to pre-crisis levels in real terms.

Secondly, we didn't want to do anything that hurt the truly disadvantaged, so we didn't make any big cuts or any cuts in things like food stamps or SSI or workers' comp. And we actually did some things to improve Social Security, while making it sustainably solvent.

Third, we do want to make sure this country is safe and secure, but we have to realize, as Admiral Mullen said, that our biggest national security problem is these deficits.

Fourth, we thought the President was right, or at least half-right, in his State of the Union when he said America must invest in education, infrastructure, and high-value-added research if we are going to be competitive in a knowledge-based global economy. What he left out is we have to do it in a fiscally responsible manner. We live in a world of limited resources; that means choices and priorities.

Fifth, as I said earlier, we believe we have to revise the Tax Code, simplify the Tax Code to broaden the base, to reduce the tax expenditures, and use the proceeds to reduce rates and to reduce the deficit.

And, lastly, we have to be serious about spending cuts. We have to cut spending wherever it is, whether it is in the Tax Code, the defense budget, the nondefense budget, discretionary budget, or the entitlement budget.

I believe if you all go big, if you are bold, and if you do it in a smart manner, that the American people will support you if you make these big, bold, smart decisions. I hope for the country's sake you will.

Thank you very much.

Chairman HENSARLING. Thank you, Mr. Bowles.

Senator Simpson, you are now recognized.

STATEMENT OF ALAN SIMPSON, CO-CHAIR, NATIONAL COMMISSION ON FISCAL RESPONSIBILITY AND REFORM

Mr. SIMPSON. Senator Murray and Representative Hensarling, it is a pleasure to be here.

I look at this panel, and I, too, know many of you. But at this stage of life, I have been around the track a while in this game. Never worked with finer people than Erskine and Alice and Pete, and have been working through years.

We don't need charts when we go out. We don't use PowerPoints. We just say, if you spend more than you earn, you lose your butt. And if you spend a buck and borrow 42 cents of it, you got to be stupid. Now, people do hear that. It is a rather wretched thing to say. And then you say, today your country is borrowing $4.6 billion and will borrow that tomorrow and the next day and the next day. If that has any common sense to the American people, it certainly has escaped us.

Now, my dad was a Governor and U.S. Senator. I know the game of inside baseball, and I know many of you well. As we wandered through this place a year ago, people came up and said, "Save us from ourselves." That is not a very smart thing to say in the duties you have to perform. So this is the toughest thing you have ever been in or ever will be in, without question, what you are doing. You have my deepest admiration and respect, all of you.

And you all know what you have to do. In your gut, you know what you have to do.

So some will say, well, you and Erskine have nothing to lose; you are not in the game. Well, that is true. But Dick Durbin and Tom Coburn had a lot to lose—a couple of diverse ideological allies.

They had something to lose, and they stepped right up to the plate and did it. They voted for our report. There were five Democrats, five Republicans, and one independent.

I used to take these people on when I was in the Congress. I did not do this suddenly. I am the only living person that had a hearing on the AARP. They went goofy, absolutely ballistic. “Why would you have a hearing on us? We do great things.” Well, that is enough of that.

So anyway, I have dealt with professional veterans, I have dealt with extremists of the senior citizens, I have dealt with emotion, guilt, fear, racism, I did immigration, Social Security. I have done it all. And I never lost an election.

I dealt with Peter Rodino, a great Democrat, and Ron Mazzoli. We did things. I took on the professional veterans. I never heard anything out of Lloyd Bentsen and Bob Dole and Dan Inouye when did we veterans stuff. It was always from some guy that had never done anything, never even been in the military.

And in immigration I was called a bigot and a racist, and yet that bill brought 3 million people out of the dark. I was very proud of that. But it never got very far because the right and the left said, this is a national ID card, heh, heh, heh. That came from the right and the left.

People admire guts and courage. They may fight you, they may vilify you, but they will admire you. I have been the toast of the town one day and toast the next. I have been on the A list and the Z list in this town when I was here. It is a funny place. You are on the cover of Time one month, and 6 months later you are doing it.

And just a quick note about Grover Norquist. If Grover Norquist is now the most powerful man in America, he should run for President. There is no question about his power. And let me tell you, he has people in thrall. That is a terrible phrase. Lincoln used it. It means your mind has been captured; you are in bondage with the soul.

So here he is. I asked him, he said, my hero is Ronald Reagan. I said, “Well, he raised taxes 11 times in his 8 years.” He says, “I don’t know, I didn’t like that at all.” I said, “Well, he did it. Why do you suppose?” He said, “I don’t know. Very disappointing.” I said, “Probably did it to make the country run.” Another sick idea.

And let’s just look at the AARP. Just this morning, I saw that ad. That is the most disgusting—the most disgusting—ad I have ever seen. I don’t know what the people got paid, especially the actors, but I can tell you this, they are well paid. They said, “We are 50 million. We are watching you. We remember, and we vote.” I tell you, that is a really ugly thing.

But let me tell you about the AARP. Let’s remember what they will be when they do nothing. We asked them what they would do to help, and they had said, we have two things we will tell you. They never did. But let me tell you what will happen with their view of the world, which is to do nothing to restore the solvency of Social Security. In the year 2036, you are going to waddle up to the window and get a check for 23 percent less. And then I hope that they will remember the AARP. I certainly will, and a lot of young people will too.

So anyway, it is a tough job, and you are going to have to do it. People are out there who are going to say, I have helped you forever, and now I never ask you for a thing, but here we are. And that is going to put a lot of heat. Well, the market will call the shots from now on. Won't need anything but that. Interest rates will go up, inflation will go up by the failure. And guess who gets hurt? The little guy. The vulnerable guy that everybody babbles about day and night will be the one hit with the hammer on the schnozz.

So remember the definition of "politics." In politics there are no right answers, only a continuous flow of compromises among groups resulting in a changing, cloudy, and ambiguous series of public decisions where appetite and ambition compete openly with knowledge and wisdom.

Thank you very much.

[The prepared joint statement of Mr. Bowles and Mr. Simpson appears in the appendix.]

Chairman HENSARLING. Thank you, Senator.

Dr. Rivlin, you are now recognized.

Dr. RIVLIN. I am going to defer to my colleague, Senator Domenici, if that is all right, to go first.

Chairman HENSARLING. Absolutely.

In that case, Senator Domenici, you are recognized. If you could pull the microphone a little closer to you, Senator.

STATEMENT OF HON. PETE DOMENICI, CO-CHAIR, DEBT REDUCTION TASK FORCE, BIPARTISAN POLICY CENTER

Mr. DOMENICI. Thank you, Mr. Chairman. I just wanted to say, the reason she asked for that privilege is we have our discussion with you planned in that order. And so we thank you very much.

First of all, let me say to the two co-chairs and the members of the committee, thank you for the opportunity to discuss with you today both the economic and fiscal challenges our Nation faces and our comprehensive plan to stabilize the national debt.

More than 18 months ago, Dr. Alice Rivlin and I decided that we should continue our decades-long work for a rational Federal fiscal policy. Our only stipulation was that everything is on the table. She and I agreed. We then invited 17 other members to join us in what became the Bipartisan Policy Center's Debt Reduction Task Force.

I tell you all of this because I think the history of the men and women that worked on this is very important to show you what kind of Americans we have out there who are worried about the future and will step up to the table and do what is necessary. The condition of their membership, those that joined us, was that they, too, would agree that everything was on the table.

Our task force ranged from Mayor Marc Morial of New Orleans to former Oklahoma Governor Frank Keating. Imagine the difference in the two. Some of you know. Yet they agreed. They agreed that we were in trouble, and they agreed that we had to solve the problem. We had liberals, conservatives, think-tank budget policymakers, former members of Presidential cabinets, people with business and labor experience. Our task force was as diverse a group of serious American citizens as you could get to address what we all believed is a looming crisis for our Nation.

Last November, we issued our report. It has been much discussed, and you and your staffs have seen it. Our recommendations, after many days, were unanimous. And they were controversial, as they should be, because they were also serious. Individually, each of us might have preferred a different mix of solutions, but each compromised to find a set of policies that we could all support.

Since then, we have seen unemployment continue to exceed 9 percent, our economy continue to stagnate. At the same time, we have endured a damaging fight over the debt-ceiling increase. We have seen another series of the melodramas on annual appropriations. And we have seen another year of deficits exceeding $1 trillion and a debt that had ballooned to over $10 trillion—that is, the debt held by the public.

With spending projected to grow faster than revenues, we will be forced to borrow more and more every year if we do not change our policies. This fiscal projection is clearly unsustainable. Now, everybody has to learn that word because that is probably the best word to explain where we are. We are an America with an unsustainable economic policy, and it will ruin us sooner or later.

This unsustainable nature has been so attested to by the Federal Reserve Chairman, Ben Bernanke; the head of the International Monetary Commission; President Obama; and almost all fiscal experts have used that word, "unsustainable." You are there trying to fix the unsustainable and make it sustainable.

Righting our fiscal house will take three things: renewed economic growth; cutting Federal spending, especially entitlements, driven in large part by Medicare and Medicaid; and pro-growth fundamental tax reform that yields significant net new revenues.

The Medicare proposal that Alice and I present to you today is the only reasonable bipartisan plan to fundamentally reform that program, make it more efficient, and preserve it for future generations.

We also present to you a comprehensive pro-growth tax reform that clears out all the special interests that are in the Code. We, like our friends who chaired the President's commission—and I listened carefully to their recommendations today—they recommended a fairer and simpler tax system. We have one similar to it, but I would think that, if you look carefully at it, it better solves the problem that we have today.

Now, let me be blunt. A plan that does not fundamentally restructure Medicare and other health entitlements will fail to adequately address the debt crisis that we face. Both sides, those who are against any fundamental health entitlement reform and those who oppose any revenue increases, will be equally complicit in bringing the Nation closer to the fiscal brink.

I hope you heard that. I said it, and it is not like me. I don't usually say that about things. But I did say, if we don't do this, those who are for fixing health care and those who are for tax increases, and they say, "We will do not one without the other; we will do only one," then they are both complicit in letting America destroy itself, letting this great democracy destroy itself, because we don't want to make tough decisions.

Additionally, while not currently the largest driver of our deficits, Social Security finances are unstable, and we must soon take action to implement some small fixes that will keep the system on solid ground for generations to come. And that can be done. That is not so difficult. Citizens will understand that.

What will happen if we continue to try to wriggle around these facts? When the debt-ceiling-increase battle caused short-term disturbances in the markets, when that happened, I had hopes that the fiscal reality would push the President and the Congress to real, fundamental action. Then, because of the turmoil in North Africa and the European debt problems of the highest order, investors rushed into quality, seen as the American sovereign debt. So instead of seeing higher interest rates for American debt, we have seen much lower interest rates. Instead of the stock market collapse, Dow Jones has been rising and going down steadily and on the upside during the last month. That is not normal for the situation we are in, but I just told you why it was.

So, are those of us who predict serious, perhaps calamitous, consequences for our fiscal policies, are we wrong? I think not. Right now, to borrow a phrase, American debt is the best house in a truly terrible neighborhood. Yes, we have rats, holes in the roof, and grass growing window-high, but other houses for global investors to store their money are even worse. And that accounts for us having lower interest rates.

However, it won't always be so. The neighbors might fix their houses or the whole neighborhood might burn. Either way, we will pay for our neglect with slower future growth. And that is the death knell for those in middle America who have been part of America's prosperity. Future growth and a less prosperous country, far less able to play a leading role in the world, is what we will present to the world if we don't fix this problem.

I am told that the Joint Select Committee doesn't have the time to truly do comprehensive reform. I believe it can create time through a fast-track mechanism using section 404 of your enabling legislation, and which we expand upon in the appendix documents in your folder. And I can say to you, those in your folder from us today, the five or six, make real sense and give you answers to almost every problem that you have before you.

I am told that the wise exchange of short-term political pain for long-term fiscal gain won't happen. I hope that is not true. Without substantial new revenues and structural entitlement reform, our fiscal ship is destined to capsize.

I am told that we need to put these kind of tax and entitlement changes off until 2013, an odd-numbered, nonelection year. Well, 2011 is an odd-numbered nonelection year. And although I am not making a prediction, we might not get to the next one unscathed. I am saying we might have the calamity before that event.

I know that the JSC has enormous power. What I don't know is whether or not they will use that power. Now, I have left one remark that was very important—I left it out here, and I want to find it so we can be sure that you understand—that those who say they will not support tax revenues unless we have entitlements, that is a good position if, in fact, you are saying, I will do it if we get both. But both are complicit. If they fail to act because each blames the other, they will both be complicit if they don't both cooperate in participating in this deficit reduction. Not one, not the tax raisers, not the entitlement cutters, but both will be complicit and will have caused America to suffer what we have described here today.

I thank you very much.

Chairman HENSARLING. Thank you, Senator Domenici.

Now we will turn to Dr. Rivlin. You are recognized.

STATEMENT OF DR. ALICE RIVLIN, CO-CHAIR, DEBT REDUCTION TASK FORCE, BIPARTISAN POLICY CENTER

Dr. RIVLIN. Thank you, Co-Chairs Murray and Hensarling and members of the committee.

I share Senator Domenici's views and those of Mr. Bowles and Senator Simpson that this committee can change the course of economic history for the better.

The United States faces two huge challenges at once: accelerating growth in job creation and reducing future deficits to stabilize the debt. There is no choice between jobs and fiscal responsibility. Both are essential, and they reinforce each other. This committee, with its extraordinary powers, has the opportunity and the obligation to address both challenges.

To achieve success, the committee will have to go well beyond the minimum charge of $1.2 trillion in savings over the next 10 years, because even savings of this magnitude would leave the debt rising faster than the economy can grow. We believe you should craft a grand bargain involving structural entitlement and tax reform that would save at least $4 trillion over 10 years. To do so, the committee should take full advantage of the authority given to you in section 404 of the act and write instructions to authorizing committees to produce tax and entitlement reforms to be considered on a fast track.

A grand bargain would reduce the chances of a devastating double-dip recession that could lead to a stagnant lost decade. It would also reassure citizens and markets that our political process is functioning in the public interest, not stuck in partisan gridlock or overwhelmed by special interests.

I was privileged to serve on both the Simpson-Bowles Commission and the Domenici-Rivlin Task Force. Both groups worked hard to find a combination of policy changes that would enhance growth and put the budget on a sustainable path. The arithmetic of the problem, far more than political considerations, drove them to similar proposals. Both concluded that two major course changes were essential: structural reform in health programs, especially Medicare, and comprehensive reform of the individual and corporate income taxes that would raise more revenue from a more pro-growth tax system. Both also advocated freezes in domestic and defense discretionary spending to encourage weeding out low-priority activities in favor of more important ones.

The Budget Control Act capped discretionary spending. We believe that further reductions in discretionary spending would risk harming essential government functions. For the same reason, we urge you to avoid the sequester. Instead, this committee should focus on reducing the growth of health-care spending and reforming the Tax Code. Our report offers solid bipartisan proposals to do this.

Our proposal for Medicare reform, which we call "defined support," would preserve traditional Medicare for all seniors who prefer a fee-for-service system. It would also offer an array of comprehensive health plans competing with traditional Medicare to deliver the same benefits. Plans could not refuse any Medicare beneficiary and would be compensated on a risk-adjusted basis. The Federal contribution would be determined by competitive bidding on a regional exchange.

We believe that the competition on a well-regulated exchange would lead providers and plans to deliver care more cost-effectively and reduce spending growth. As a fail-safe, the Federal contribution would be capped at GDP growth plus 1 percent. Excess costs, if any, would result in an increased premium, but low- and moderate-income beneficiaries would be protected from these increased payments. This bipartisan proposal would preserve Medicare for our rapidly rising population of seniors.

On tax reform, while growth in spending must be controlled, we do not believe that the projected tsunami of retirees can be absorbed by Federal programs without increasing revenues. Stabilizing the debt by spending cuts alone would cripple essential government functions and responses to human needs.

Moreover, as our colleagues have stressed, our current Tax Code is riddled with exclusions, exemptions, deductions, and other special provisions that distort economic activity, narrow the tax base so much that rates are unnecessarily high. Our proposed Tax Code would have only two individual rates, 15 and 28 percent, and one corporate rate, 28 percent. Most special treatment of income or spending would be eliminated or phased out. Capital gains, dividends, and so-called carried interest would be taxed at ordinary rates. Credits would be allowed for earned income, children, charitable contributions, mortgage interest on primary residences up to a limit, and retirement contributions. The exclusion of employer-paid health care from taxable income would be phased out, which we regard as both a tax and a health-care reform.

We believe, like our colleagues, that this simpler Tax Code would be both fairer and more conducive to economic growth. It would raise more revenue than current policy, but less than current law, and do it in a more progressive fashion.

We fully appreciate the difficulty of the choices facing this committee and hope you have the courage to restore fiscal responsibility and avoid the truly dire consequences of partisan gridlock.

Thank you very much.

[The prepared joint statement of Mr. Domenici and Dr. Rivlin appears in the appendix.]

Chairman HENSARLING. I thank you, Dr. Rivlin.

Thank you for the entire panel.

The chair will now yield to himself for 10 minutes.

I believe one of the things I have heard from all of the panelists—and I have certainly heard the revenue message, and we will go back to that—but I think I heard particularly you, Senator

Domenici, say that the number-one challenge that we have with respect to our debt is health care. Is that correct?

And I think, Mr. Bowles, I heard you say something similar.

Is there a consensus among the panel that the number-one challenge we face in our structural debt crisis is health care? No one is diverting from that?

Dr. Rivlin, I have a question, then, for you.

Mr. DOMENICI. Mr. Chairman, I want——

Chairman HENSARLING. Yes, Senator Domenici.

Mr. DOMENICI. I just wanted to ask if they would put up the chart that is very explicit on this. You cannot miss it.

Chairman HENSARLING. If you have a number for me, I would be glad to have the staff put it up.

Mr. DOMENICI. We don't use this, so I don't know—somebody said they would put it——

Chairman HENSARLING. I bet you somebody enterprising will be able to find that.

Mr. DOMENICI. They showed me just before we met.

Chairman HENSARLING. "Wake up, folks, it's health care." That appears to be how you entitled your slide. If the staff can pull that one up, please.

Mr. DOMENICI. I would ask them if they could put it back.

Dr. RIVLIN. There it is.

Chairman HENSARLING. Well, that is one of them.

Dr. RIVLIN. That is it.

Chairman HENSARLING. That is it?

Mr. DOMENICI. That is these various governmental functions versus GDP. And look which one, that blue line up there, that is health care. Look at the lines underneath. Those are big-ticket items that people think—but look at what is happening to health care.

I am going to give you a word. If we do not produce a plan that would permit CBO to say that the line has been bent—the line has been bent—if that isn't in the plan, then you have not caused in a major way a reform of health care. Because if that line keeps going that way, you have solved nothing. So it must start to bend someplace.

Chairman HENSARLING. So you are not speaking of simply slowing the rate of growth; you are talking about a plan that actually bends the cost curve.

Mr. DOMENICI. That is correct. And that is what we do.

Chairman HENSARLING. Dr. Rivlin, having the honor and, actually, pleasure of serving with you and Senator Simpson and Mr. Bowles on President Obama's Fiscal Responsibility Commission, I was somewhat familiar with your plan, with House Budget Committee Chairman Paul Ryan, on a Medicare premium support system. And you now have what I believe you have called a defined support system. And as I was listening to your testimony, it includes an aspect of maintaining some facet of the current fee-for-service aspect of Medicare.

But could you tell me why this form of defined support is critical to saving us from the national debt crisis? And how does it differ from your earlier premium support plan with Chairman Ryan?

Dr. RIVLIN. I think it differs in several respects. The most important one is the one you noted, that it preserves traditional Medicare for anyone who wants it. And I think that is important. It is important to seniors, and it is important to have—you should forgive the expression—a public option.

But in addition to traditional Medicare, it sets up Medicare exchanges, where seniors would choose among an array of plans that provided at least the same benefits as Medicare and competed with each other and with traditional Medicare to produce them in the most cost-effective way. We believe that that would control the costs, that the costs would go up much less rapidly. And that would be part of bending the curve, as the Senator says.

We have, however, a fail-safe mechanism in there. If the competition does not result in bending the curve enough, we would say the defined support, the Federal contribution, would not go up faster than the GDP grows plus 1 percent. And if it did, there would be additional premiums for those choosing the more expensive plan, but those premiums would not apply to low-income people.

That is the plan in a nutshell.

Chairman HENSARLING. Thank you.

A question for you, Mr. Bowles and Senator Simpson. And, again, it was both an honor and a pleasure to serve on your commission. I again want to say that I think you have contributed mightily to the Nation's consciousness. And I hope that whatever success that this Joint Select Committee achieves, part of it will certainly be on your shoulders and your previous good work.

Let me ask this question, having served alongside you all. And there was much great work that was done on the Commission. One of my personal reservations was that the Commission did not adopt the Rivlin-Ryan premium support plan. I thought the work particularly in Social Security—and if I have time, I want to go back to what you do on the 75-year solvency.

But on Medicare, which is really a larger, long-term challenge, we seemed on the Commission to apply much smaller, short-term reforms. You did put the 1-percent-plus-GDP cap, if I recall right, on total health-care spending, with a trigger of expedited procedures, if I recall right, to go to both bodies to fix the problem, but it wasn't a hard trigger.

So, two questions. Do you believe in the defined support system policy that was just articulated by Senator Domenici and Dr. Rivlin? And if you do, why didn't we adopt something like that in Simpson-Bowles? I assume either, one, you didn't agree with the policy or, two, you didn't have the votes. Or maybe there is a third option.

Mr. BOWLES. Probably both.

What we tried to do was to look at it on a realistic basis. If you look at the cost of Medicare and Medicaid alone today, it is about 6 percent of GDP, and it is growing like a weed. And that excludes what it takes to do—the $267 billion to do the doc fix, over $76 billion to repeal the CLASS Act. So it really is a big portion of our cost. It is, as, again, was said earlier, it is also, I believe, our biggest challenge from a fiscal viewpoint.

As we looked at the Affordable Health Care Act which was recently passed, it was the contention of the Democrats on our commission that the cuts that were made to Medicare in the Affordable Health Care Act, along with the pilot programs that were set up, would reduce the rate of growth of health care to GDP plus 1.

Chairman HENSARLING. If I could interrupt, most of those cuts on the provider side, if I recall.

Mr. BOWLES. That is correct. That is correct.

We didn't think that would happen; we didn't think those cuts were enough. So we did about $500 billion of additional cuts over and above that, with the hope that those cuts would slow the rate of growth of health care to GDP plus 1.

But assuming that that didn't happen, you know, to us, there was no choice but to get the rate of growth to health care to that level, and we said there were certain options that would have to be considered at that point in time. And those options did include a premium support plan, it did include a robust public option, it did include even a single- or an all-payer plan.

Chairman HENSARLING. I see my time is about to run out here. Let me quickly cover two other subjects.

With respect to both of your plans on raising revenue, I do note that, as part of that, marginal rates are brought down in both plans. Is that correct? The witnesses are saying "yes."

I have less than a minute remaining in my time. Also, I was looking for certain common elements of your plans, one of which is global chained CPI throughout the entirety of government programs. And in the very short time that we have left, maybe I could get a 30-second answer out of each of you, why you thought that was a critical part of the solution.

Senator Domenici—okay, well, Dr. Rivlin, a brief answer on chained CPI?

Dr. RIVLIN. Yes, it is a technical change that economists have, for quite a while, decided was a better way, a more accurate way of measuring the cost of living for this purpose. And it would affect all government programs, including the Tax Code.

Chairman HENSARLING. So the COLA would still be there; it simply would rise at a different rate.

Dr. RIVLIN. Oh, absolutely. It is just a technical change in how you calculate the COLA and the index that is used for other programs with COLAs, including the Tax Code, which indexes the brackets.

Chairman HENSARLING. Senator Simpson, I am technically out of time, but could I get a quick answer on chained CPI?

Mr. SIMPSON. Everything we looked at, people had looked at it. It is better. Although there are suggestions for something else, CPI–I, but that is experimental. This one looks like everyone would adopt it. And if we could do it government-wide, it saves billions.

Chairman HENSARLING. I thank you, Senator.

The co-chair will now yield to his co-chair, Senator Murray, for 10 minutes.

Co-Chair MURRAY. Thank you very much.

And, again, thank you to all of you for your wise counsel on a very serious challenge.

Let me just start, it seems both of your prospective proposals would achieve deficit reduction of at least $4 trillion over the next

10 years through the use of a balanced-approach framework that includes reductions in spending and increases in revenue.

So let me just ask all of you, maybe by show of hands, do all of you believe that to get a balanced program that addresses the fiscal crisis, do we need both spending cuts, including entitlement reform, and revenue increases? Show of hands?

Mr. SIMPSON. No question, yes.

Co-Chair MURRAY. Okay. Well, let me start, then, with Senator Simpson and Ms. Rivlin. Maybe both of you can answer for your sides. Tell us why a balanced approach that includes both reductions in spending and increases in revenue was proposed by your committees.

Mr. SIMPSON. Well, we know you can't cut-spending your way out of this, you can't tax your way out of it. If you get into some of the rates that would happen if you are doing taxes or whatever it is, it can't be.

And we tire of the phrase "tax increase" when we are digging around in a $1.1 trillion stack of stuff called tax expenditures, which really affect about 5 percent of the American people. The little guy has never heard of half of them. And we said, let's take those, let's take those. And when you take one of those out, to call that a tax increase is a terminological inexactitude. It would be called a lie, in other words. And that is where that is. This is a fake, to say that you get rid of a tax expenditure and it is a tax increase.

So we said we are not going to get into that business of tax increase so that Grover won't have a stroke over in his shop; we are just going to go around Grover and let Grover rant. Because I will tell you one thing, if he and the AARP—if we are in thrall to those two groups, we haven't got a prayer, and neither have you.

Co-Chair MURRAY. Dr. Rivlin?

Dr. RIVLIN. I agree, we were attacking expenditures in the Tax Code, and they are almost identical with expenditures that are called spending.

There is another reason, however, why you need a balanced approach, and that, I think, is the demographics. This government is going to have to absorb a doubling of the number of people over 65 in the next couple of decades. That is an awful lot of people. That isn't changing the role of government; that is absorbing a lot more people, which we can't do unless we have some more revenue.

We must bend the curve on health care. We must fix Social Security. But we can't do it in such a drastic way that we can absorb all of those people without some more revenue.

Co-Chair MURRAY. Okay.

Mr. DOMENICI. Madam Chairman?

Co-Chair MURRAY. Yes, Senator Domenici?

Mr. DOMENICI. Might I just say, I think you all know, at least you, Madam Chairman, and a couple of other Senators there know me and have known me for a long time. And I didn't come on this committee trying to get anything—I didn't have any preconceived percentages that we used to work on. I said, let's start over.

And the truth of the matter is, even when you fix Medicare in any reasonable way and bend the curve so that over 20 years you really get some savings, the deficit is still too big unless you decide to fill that gap with something. In other words, you don't have a viable budget versus the economy situation. So you have to look to the only thing that is left, because you have done the others. And we did it that way.

Co-Chair MURRAY. I very much appreciate that response.

And, Mr. Bowles, let me ask you, in the guiding principles and values that were established by your commission to guide in the development of your recommendations, you state that "growth is essential to restoring fiscal strength and balance, and deficit reduction must not disrupt the fragile economic recovery."

CBO and many economists agree that the rate of economic growth in the recovery projected for the remainder of this year and through 2012 was considerably stronger when your commission put out its recommendation than it is today.

So I wanted to ask you if you believe, first of all, that the Commission was successful in adhering to those economic principles, but also whether, given the weaker projections for today, whether we should be doing more now for economic growth and reducing unemployment.

Mr. BOWLES. First of all, our commission, it was the number one founding principle in our commission that we didn't want to do anything that we considered to be overtly stupid, and we felt it would be overtly stupid to do anything to disrupt what is clearly a very fragile economy and in fact a very fragile economic recovery.

Therefore, if you look at the cuts that we made in 2011 and 2012, you will see that those cuts are quite small. However, we thought it was very important for us to get spending down, and so we did make significant cuts in spending in 2013, and those spending cuts do get us back to 2008 levels or pre-crisis levels of spending.

When we came forward with that provision, lots of people thought, you know, that we were being too conservative. They said the recovery is real, that if you look at things like back in December, as you asked about, there was an increase in factory production, existing home sales were going up, retail sales were going up, it looked like banks were starting to lend to small businesses, unemployment was starting to come down, and investor sentiment was strong, and therefore people said at that point in time the recovery is real.

We, on the other hand, felt while the recovery may be real, it was very, very fragile, and the reason we thought it was fragile, and I think that has been proven to be right over time, is that we were very concerned about demand. Demand comes from three basic sources. You know, the consumer is still two-thirds of GDP, and in our cases we looked at consumer debt or household debt, it was still about 120 percent of household income, it was about $13 trillion outstanding. Over half of it was at floating rates. And if you think that a rise in food prices and gas prices took a bite out of consumer demand, you wait until interest rates go up. So we didn't see the consumer who had suffered a decline in their home value and a loss of income driving the economic recovery.

Second leg of growth would come from business. It is a fact small businesses can't grow and can't create jobs without capital, and banks simply weren't lending to small businesses, and so we didn't see that the small business community would be able to lead us out of the recovery, and with big businesses who had plenty of capital, their capital was basically on strike because they didn't have confidence in the direction the country was going or didn't know which direction the country was going in, and lastly, it is hard to see business really lead us out of a recovery when the construction industry is really on its backside.

The third level of economic growth would come from government. We didn't foresee an additional big stimulus package coming out of Washington to add growth to the economy, and if you look at what State and local governments were doing, they were actually cutting spending and laying people off, trying to balance their budgets. So we didn't see where the growth would come to drive the economic recovery.

Myself, I believe we are in a structural contraction which will lead to a prolonged period of relatively slow growth and relatively high unemployment.

Co-Chair MURRAY. Dr. Rivlin, your plan also addressed the concern of accelerating the recovery and phasing in some kind of deficit reduction, and I think you also were worried about the demand. Can you talk to us about what you did in your proposal?

Dr. RIVLIN. Yes, we were very worried about inadequate demand, and so we not only phased in the deficit reduction slowly, but we called for a 1-year, both sides, employer and employee, payroll tax holiday on the grounds that that was needed to stimulate demand upfront before we could safely phase into the deficit reduction that we were calling for. That was at a time when the economy was somewhat stronger; it seems to us even more necessary now.

Co-Chair MURRAY. Did you have anything besides the payroll tax to stimulate jobs in your plan?

Dr. RIVLIN. No. We put that in as a kind of symbol of how concerned we were, a full year payroll tax holiday for employer and employee is, I think, $650 billion. That is a lot. Now, you could do it different ways. But we put it in to symbolize the fact that we were really worried about inadequate demand.

Mr. DOMENICI. Madam Chairman, I might comment on that. Frankly, I was very surprised in looking at the group of people that were on this debt reduction group, when it came to this issue, they were as worried as on any issue I had seen because they were really fearful that the economy was not going to recover. Frankly, we don't know what will make it recover, but Alice has appropriately told you what came about, how we came about what we did, and it is a lot of money. I guess some of us said that it might have been a much better thing to have done 2 years ago than whatever we tried to bring jobs. This might be a better way than anything we did, so we said let's suggest it.

Co-Chair MURRAY. Okay, appreciate that very much. My time has expired, so thank you very much.

Chairman HENSARLING. The co-chair now recognizes Senator Kyl from Arizona.

Senator KYL. Thank you. First to Senator Domenici and Senator Simpson, it is great to see you both again, and to all four panelists, thank you for the, what, thousands of hours that you have put in on these subjects, and it has been helpful to everyone. Senator

Simpson, you never disappoint. This is a serious subject but a little levity sometimes can help, and I appreciate that.

You talked about eliminating so-called tax expenditures, and I just have one quick question for you, a comment on taxes, and then I would like to talk about entitlement reform. If you eliminated the so-called tax expenditures, the biggest four of which on the personal side are deductions for medical expenses, charitable contributions, mortgage interest payments, and payments of State and local taxes, and you don't reduce marginal tax rates commensurately, the roughly one-third of Americans who itemize would have a higher effective tax burden, would they not? In other words, they would pay more in income taxes?

Mr. SIMPSON. Well, we, in getting rid of the 1 trillion 100 billion suggested that the $100 billion would go toward reduction of the debt and the rest of it would come out, and we would give the people of America what they have been asking for, broaden the base, lower the rates, get spending out of the code, and we said we will give three rates: 0 to 70 grand you pay 8 percent, 70 grand to 210 you pay 14, and everything over 210 you pay 23, and take the corporate rate to 26 from 36. But if you want to put something back, go ahead. The issue being if you want it, pay for it. So then you could go to rates of 12 and 18 or whatever you want to do. We said give—on home mortgage interest deduction, give them a 12½ percent nonrefundable tax credit, that helps the little guy. If you want to do charitable contributions, give them a 12½ percent nonrefundable tax credit. We realize those things, municipal bonds. But at some point you just say, look, you were told to bring home the bacon, the lobbyists got you what you wanted, and now it is over, the fun and games is over.

Senator KYL. So do I understand of the $1.1 trillion, $1 trillion of that would go for rate reduction?

Mr. SIMPSON. That is correct.

Senator KYL. And only $100 billion for debt reduction?

Mr. SIMPSON. That is correct, Jon, and it is good to see you, we served together, but let me just say, if you want to put something back, and they are wonderful things, earned income tax credit, you can get the violin out if you want to talk about what you are doing.

Senator KYL. Let me not take the time to do all that.

Mr. SIMPSON. No, I don't want to do that.

Senator KYL. Let me just make one observation, and then I do want to get to the entitlement spending. Both the Fiscal Commission and the Bipartisan Policy Center have suggested that one of the options here is to tax capital gains and dividends at ordinary income tax rates.

Now, you started the testimony by noting that you wouldn't want to do anything to disrupt a fragile economic recovery, sort of along the line of first do no harm, and my own observation is I think you could do great harm by effectively doubling the capital gains and dividends taxes because those represent areas of capital formation and investment in our economy.

Let me just make a quick observation here. The government receives capital gains revenues when taxpayers sell appreciated assets. The technical terms are called realizations. Now, Congress tried taxing capital gains at the same rate as ordinary income before—this was back in 1986—and the resulting capital gains revenues were dismal. In fact, they shrunk and remained depressed for a decade until Congress lowered the capital gains rate in 1997. Higher capital gains taxes mean fewer realizations, a higher cost of capital, less activity in the capital markets, and less economic growth.

The health care bill that was passed last year already increases capital gains and dividends rates by another 3.8 percent, and that means that the very lowest capital gains rate under your suggestion would be 26.8 percent, the highest would be 32.8. In other words, more than double the existing rate, and even the Joint Committee on Taxation would say that a rate that high will actually lose, not gain, revenue, and that doesn't even account for the negative impact on economic growth.

Other economists, ones who testified before our Finance Committee, said letting the top capital gains and dividends rate drift up to 20 percent will erase the theoretical revenue gain from increasing the tax rate and will lower both economic growth and wages. If the rate is pushed even higher, more revenue and GDP will be lost, and wages will be even lower.

So I would just ask you all, as we continue to visit about these things, to think about this. Your views are important to the committee, but in this one respect I think it could be very counterproductive by lowering economic growth, not really raising revenues, and it would make our deficit problem worse.

Now, let me turn to entitlements here because, Dr. Rivlin, I think you said something very important in response to Representative Hensarling's questions, and I want to make sure that I have this right. First of all, I think it would be useful for you to explain the benefits of a defined support or a premium support such as you recommend. If you could do that generally. But also correct me if I am wrong, but I understood you to describe the plan laid out in your submitted testimony, which is a little different than the original Domenici-Rivlin in that at least there are two attributes. First of all, you would actually—do you actually set the contribution, the Federal contribution level first by the second lowest bid, which would include fee for service but have the fail-safe, as you described it, that in no event would it go up more than GDP plus 1 with a sort of means tested premium support in the event that it did so? If that is not accurate, please tell me how I am wrong.

Dr. RIVLIN. Senator, you have it exactly right. We have improved this plan, I think, over our original one. It is now more like the bipartisan plan in the Breaux-Thomas proposal of the late 1990s, and one of the complaints that we got about the way we did it originally was it didn't reflect the actual costs of health care. When you do it by a bidding process, then it does reflect the actual cost.

Senator KYL. And also, as you are describing the benefits of this, talk about how you select the second lowest bid because I think that is a very clever way to do this.

Dr. RIVLIN. Well, that is arguable. There are different ways of doing it, but we thought——

Senator KYL. I thought it was.

Dr. RIVLIN [continuing]. Selecting the second lowest bid gave—it wasn't the lowest, which might well be flukishly low for some reason, but people then who wanted to go to the even lower bid, the one that wasn't selected could do so and could get some money back.

Senator KYL. They would pocket the difference between the second bid and the one——

Dr. RIVLIN. Right.

Senator KYL. And if they wanted to be no dollar out of pocket, they would take the second lowest bid plans.

Dr. RIVLIN. Right.

Senator KYL. And of course anybody could offer plans at that level, and if somebody offered a plan that was more expensive, perhaps it had a different set of benefits or whatever, then they could pay for it, but the Federal premium support would only be at that second lowest bid.

Dr. RIVLIN. That is right. So it gives you a way of making the competition real, and we believe that would bring the costs down.

Senator KYL. I agree with that. Now let me go back to my first question there. Discuss the benefits of that premium support concept generally because I think it is not necessarily well understood. And then the final question I will ask is, that is not all that you would recommend. You also recommend—and this is really a question for all of you, but additional changes to the existing system that we have in order to potentially reduce expenditures, things like combining the part A and part B, increasing premiums under certain circumstances. I have forgotten whether you get into the co-pay issue or not. But could you also discuss whether some of those things are useful to do even if we do the premium support, but in any event, certainly if we don't do it.

Dr. RIVLIN. Yes, and I think also the things that Erskine Bowles mentioned, that the pilot programs and attempts to find better ways of delivering care and government support and private support for innovations and testing those things and putting them out in the public domain, that is all a very good thing to do, and we think it will pay off in the end, and it is not incompatible with our defined support plan because once you have those innovations out there in the public domain, the private sector is going to pick them up, Medicare will use them, things will get better.

Senator KYL. Hopefully reduce costs.

Mr. DOMENICI. Mr. Chairman, Madam Chairman, might I just follow up with Senator Kyl with one observation? On this one that you are speaking of on Medicare, the first thing that we did was to note the objection to a new system, and it was generally right upfront that you are abolishing Medicare, and so this new plan starts with the premise, we will have both programs, and you can choose, and that put us on a completely different path with our members than before, and it is very different than anything you all have considered, excuse me, you all in the House have considered heretofore when you took this subject up.

Senator KYL. An important observation. Thank you.

Mr. BOWLES. Actually, I didn't say it, Senator, but in our plan we did try to address this issue. Our belief was the current benefits structure encourages overuse, and there are currently a hodgepodge of different co-pays and deductibles and premiums. We wanted more cost sharing in our plan, we wanted people to have some skin in the game, we wanted to get rid of first dollar coverage for that reason. So we went to one deductible on part A and part B of $550. We had a 20 percent payment up to $5,500, and then a 5 percent co-pay up to $75,000 and capped out at that level. We also on Medigap, we had no Medigap would be available for the first 500 and then 50/50 up to $5,000.

Senator KYL. All of those I think are very useful suggestions, and I appreciate them all. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The co-chair now recognizes the gentleman from California, Congressman Becerra.

Representative BECERRA. Thank you, Mr. Chairman. To all of you, thank you very much for your service to this country and for the work you have done to give us some templates that we can use to try to resolve this issue for not just the Congress but for our country.

I enjoy always hearing from the four of you because you have shown us that you can be big, you can be bold, and you can be balanced and still try to move the country forward, so I thank you for that, and as I said to both Alan and Erskine on many occasions, I thank you so much for attacking those sacred cows that too often get in the way of Congress being able to deal with those things that are most important. I honestly think, and I served on that Commission with you, as I said before, I thought you put all the elements in place. I would have put the mixture of those elements differently, but I compliment you today, as I did back then, and I applaud you for what you did in putting together the template of what could be a solution for the country.

I think I heard you all say this, but I want to make sure about this. While we are still suffering through these difficult economic times and back when we were going through this with the Commission, and Director Rivlin, I know that you and Senator Domenici were also going through this as well when you were coming up with your plan, times were tough. Well, they are still tough, and I suspect all of us back when we were going through the work of these two Commissions thought that the country, the economy was doing far better.

Is it still your premise that we should really concentrate on getting the economy back on track, getting Americans back to work before we go too heavily into trying to find these savings by making cuts in some of these important investments that we have? And I will open it up to anyone to answer. Director?

Dr. RIVLIN. It is a timing question, Mr. Becerra. We believe that drastic cuts in spending right now would be damaging to the economy, as would tax increases right now. We need to let the recovery happen and indeed stimulate it with proposals that we have been talking about. But that doesn't mean putting off the deficit reduction. One of the best things we could do for the growth of the economy right now is for this committee to legislate long-run reduction in the deficit on the entitlement and tax side right now. We can't wait until after 2013 or some other time to do that. The markets and the public have got to see that it is going to happen, that we are serious, and that it is in law. Then it doesn't have to take effect right away, but it has got to be in the law.

Representative BECERRA. So let it play itself through, get it done, let it play itself out, you have time for it to take effect long term as you see the economy begin to recover?

Dr. RIVLIN. Right. But don't wait to legislate it.

Representative BECERRA. Got it, got it.

May I ask a question regarding revenues? You all tackled the issue of revenues, you did it in somewhat different ways, but for the most part you did something that I thought was very important. You tried to also show the public that while we would increase real revenues, we would ultimately try to reduce the rates and give people a fair taxation system, and so that while we were still able to generate revenues, which we need, you are able also to tell the public that they are going to have a system that works better for them, and so that they could understand the simplicity and the fairness of it.

In both plans I believe, and we have had a little discussion on this, you equalized the taxation for capital gains and dividends to ordinary income or, in layman's terms, an asset, an investment in stocks or bonds would now be taxed at the same rate that the income earned by a hard working American would be taxed at, so they would be treated equally. You also found ways to reduce the rates overall for all income groups, and you went after what I know in the Bowles-Simpson Commission became known as tax earmarks, those tax expenditures which I believe, Senator Simpson, you mentioned totaled over a trillion dollars. And so you came up with a mix. Again, you tackled some sacred cows, and you came up with a mix.

Is it still your sense that that type of a mix can work for this committee? Open it up to anyone.

Mr. DOMENICI. Sir, I will say absolutely, and I would say to my friend Senator Kyl when he talks about capital gains, if you look at my record, I have voted in favor of capital gains for my 36 years in the Senate, but I didn't have a chance to lower the rates like we are lowering them at the same time that you were looking at capital gains. In this case that is what happened. We lowered the rates.

Now, I heard from the best experts this country could put before me when I was chairing that the best way to effect growth in this country is to lower the rates on all people. That was the best instrument of growth. They didn't say except for capital gains. They said it is the best instrument for growth, and we lowered it all substantially, so we put back into the code the instruments of growth which is the lowering of the rates on middle America and all Americans, which we did in ours and they did in theirs. Theirs is a little stronger in terms of, as Al explained it, they have come down lower so you can put back some things.

I would tell you, we also included in this, so you don't forget, we put in the medical expenses, which is the largest tax expenditure. It is bigger than homeowner interest rates. We phased that out over a long term. That is a very difficult one, but we did it in ours, and you all should know that is part of the reason we got the rates we got.

Representative BECERRA. And, Erskine, I think you called the tax expenditures backdoor spending through the Tax Code?

Mr. BOWLES. It is, Congressman. It is just spending by another name. I was flabbergasted, I was appalled to see that, you know, having listened to all the talk about earmarks all these years which are in the appropriations bills, there are about $16 billion worth of annual earmarks a year. There are $1.1 trillion worth of annual earmarks in the Tax Code. And it is just spending by another name. It is somebody's social policy. And if you were to eliminate them and use 92 percent of the proceeds to reduce rates and only 8 percent of the proceeds to reduce the deficit, you could reduce the deficit by about $100 billion a year, so a total over a 10-year window of about a trillion dollars, and you could take rates to 8 percent up to $70,000, 14 percent up to $210,000, and have a maximum rate of 23 percent. You could take the corporate rate to 26 percent, and you could pay for a territorial system so that $1 trillion that is captured overseas could be brought back to this country to create jobs over here. I believe that would create dynamic growth in this country and produce revenues far beyond what we have forecast. So I am very excited about broadening the base and simplifying the code. I think it makes a lot of difference.

Representative BECERRA. And I would love to focus on a couple more areas of spending. I know that when we talk about spending you also were willing to tackle this issue of the discretionary side of the budget, the kind of spending we typically talk about, but most people don't recognize that 65 percent of all the spending increases that occurred over the 10 years, the last 10 years came out of just one department, the Department of Defense, mostly because of the war, but because of the growth in some of our military projects and contracts and so forth. I know that you tried to tackle that some and I appreciate the work that you did there.

With the limited amount of time that I have, I would like to touch on health care, and I appreciate what each of the Commissions tried to do on health care, but let me just pose one question. Perhaps you can help us with this. We could do any number of things to try to reduce the cost of Medicare and Medicaid for the American public, but at the end of the day if we do nothing to try to help lower the cost of health care overall, not just within the public sector, within Medicare/Medicaid, we will simply have shifted the expense of health care in Medicare/Medicaid to those who use health care through Medicare/Medicaid, to our seniors and our disabled because the reality is that today the cost of health care under Medicare is growing slower than the cost of health care in the private insurance market. We went through that in the Bowles-Simpson Commission, how it is really strange, we are talking about the crisis in health care. The reality is if you were to get rid of Medicare and send seniors over to the private sector insurance market, they would actually end up paying more because the cost of private insurance is growing at a faster clip than is Medicare/Medicaid. So the issue is, how do we corral the cost of health care which it could hit Medicare/Medicaid, so that way we don't end up just shifting costs from the people, the taxpayers, to the actual beneficiaries, in this case our seniors who are now retired.

So if you can give that some thought, that would be very instructive. I know that the health reform of last year meant to do that, to try to help corral the cost in the private sector, but if we don't do something about overall health care costs, simply telling seniors that they will end up paying more in Medicare doesn't help with our health care costs.

Thank you for your service to this country and your time.

Chairman HENSARLING. The time of the gentleman has expired. The co-chair now recognizes Congressman Upton of Michigan.

Mr. UPTON. Well, thank you, Mr. Chairman, and I certainly want to agree with each of you that these deficits are unsustainable. I appreciate your candor, your service, your hard work. Believe me, we know a little bit about your work because we together have spent hundreds of hours as well over the last number of weeks, and you underscore my respect for each of you as truly great Americans.

As you may know, my home State of Michigan, Dave Camp's as well, we have had 34 consecutive months of double digit unemployment, and as I talk to people back home, as I was again this past weekend, people know we are in a rut. Senator Simpson, they know exactly what you are talking about. And they, in fact, are relying on us to try and get our car out of the ditch and back in first gear.

I put a chart, I can't see it very well up here, but I think you have a chart I think in front of you that scores the President's health care plan from 2014 to 2023, and that 10-year outlay plan shows that spending, the effects on the Federal deficit will be almost $2 trillion in additional spending over the next 10 years.

[The chart appears in the appendix on p. 108.]

Representative UPTON. And each of you noted in your various proposals that the Federal budget is on this unsustainable path, and you identified health care as one of the most important items that this committee and the Nation should be focusing on.

So as you see from this chart, that the exchange subsidies are certainly the primary driver of this dramatic expansion of Medicaid. CMS actually certified that because of the President's proposal, nearly 25 million more Americans will be on Medicaid after 2014 because of that expansion, which means that more than one in four Americans will be, in fact, a Medicaid beneficiary.

So based on that and the statements that you have made about the budget crisis, do you believe that we should revisit the expansion of the Medicaid program in the President's proposal? Erskine? Sorry that you start on that end.

Mr. BOWLES. No, no, I am very happy to answer any question that you ask. You won't smell any fear on us out here.

Mr. SIMPSON. Go right ahead.

Mr. BOWLES. We had great questions that if the affordable health care plan could actually slow the rate of growth of health care to GDP plus 1. Because we had those questions, we did believe it would solve the problem of providing more people health care, but we didn't think it solved the problem of how to control the cost of health care, and therefore we made the $500 billion worth of additional cuts to both Medicare and Medicaid and certain other Federal health care programs in order to—and hoping that that would slow the rate of growth. If it didn't slow the rate of growth, then what we said is there has got to be an overall cap on all of these areas of spending, of Federal health care spending, and you are going to have to look at some options like a premium support plan, like the robust public option, like a single payer plan.

Representative UPTON. Alice? Or, I am sorry, Alan.

Mr. SIMPSON. We just knew that whatever you call it, if you want to use the negatives or call it ObamaCare or any kind of care you want to, it won't work. It can't work because all you have to do is use common sense. You have this imploding of people, you have diabetes, you have one person in America weighs more than the other two, you have got guys who choose to do tobacco, who choose to do booze, who choose to do designer drugs, and all of them will be taken care of. You have got preexisting conditions in 3-year-olds. What happens through their 60 years or 50 years of life? All you have to do is forget the charts and know that if you torture statistics long enough, they will eventually confess, and know that this country cannot exist on any kind of situation where a guy who could buy this building gets a $150,000 heart operation and doesn't even get a bill. Now, that is nuts, and that is where we are in America. There is no affluence testing, you have got to raise co-pays, you have got to knock down providers, you have got to deal with physicians, you have got to have hospitals keep one set of books instead of two. That would be a start.

Representative UPTON. Alan, what did you do about Medicaid? Because originally you all had, as I understand it, you were going to convert it into a block grant for the States, and it is my understanding that you dropped that proposal; is that right?

Mr. BOWLES. We were never going to convert it into a block grant for the States. One of the things that—we felt that was too big of a shift, too unproven of a theory. What we did advocate is testing it in 10 States. It is on the theory that one size doesn't fit all, that Governors can cover more people with less cost if they have control of the funds. So we said let's test it in 10 States. If it does prove to be something that does lower the cost of health care and still provides coverage to people who need it, then we could support it, but you ought to test it first. I think that is what you would do in the business world, I think that is what you would do in most places.

It is now being tested in Rhode Island. It is working very well. I understand Washington State is actually asking if they can test it. So I do think it is one of the things that will prove out over time.

Representative UPTON. So beyond those tests did you ask for any other reforms on the Medicaid side?

Mr. BOWLES. Yes, we did.

Representative UPTON. And they were?

Mr. BOWLES. As an example, having run the public hospital in North Carolina for the last 5 years, you know, you can see the gaming that goes on in the Medicaid program by the payments, since it is a shared cost program, that is approximately 50/50 between the States and the Federal Government, you know, the docs would up the amount they would charge in order to cover higher fees charged by the State. They would both come out even, but the taxpayers would end up with about a $50 billion bill for that. So we cut out that kind of gaming in the State Medicaid programs.

Representative UPTON. Now, Alice, one of the proposals that you all recognized on the Medicaid side was this program called the per capita cap, which for those in the audience would actually, each State would receive an allotment determined by the number of folks in the specific categories for Medicaid based on the State population number for those numbers, and then that would be increased each year by GDP plus 1 beginning, I want to say, in 2014, 2015. Do you—are you a part of that proposal? I know way back when. Are you still supporting that idea?

Dr. RIVLIN. We looked at a number of ways to reduce the rate of growth of costs in Medicaid. One was splitting the responsibility between the Federal Government and the States. Medicaid is really two programs. It is acute care, which is largely for children and their mothers, and it is long-term care, and one of the things we looked at was split the responsibility for those two between the Federal Government and the States. We thought that would help make it clearer who is responsible for what, and not have the matching program that results in a certain amount of gaming. We also wanted to get rid of the kind of gaming that goes on in Medicaid, as Mr. Bowles has suggested, and one thing we were very clear about was the dual eligibles, those who were eligible for both Medicaid and Medicare. There is some impediments to their getting into managed care and management of their usually multiple diseases, and we wanted to fix that.

Representative UPTON. And what did you do in terms of added State flexibility to allow the States to be able to have greater control over what services were eligible?

Dr. RIVLIN. That is certainly a possibility. We did not, frankly, come down very clearly. We offered a menu of options on what to do about Medicaid. I think it is the hardest problem, much harder than Medicare, and we thought we had a good plan for Medicare. We offered a menu for Medicaid.

Representative UPTON. On Medicare, both Ways and Means and Energy and Commerce have jurisdiction over this issue, and I know that as many of us have looked at this, we have felt that it is the toughest entitlement to try and curb the cost curve downwards. We have heard a little bit about A and B, putting them together, the deductibles, the co-pay. It is my understanding that both of your groups also increased the age, is that right, for eligibility?

Dr. RIVLIN. No, we did not. We didn't even do it for Social Security. But we certainly did not for Medicare.

Mr. BOWLES. We have it as one of the options out in the 10-year window. It is not in the first 10-year window.

Representative UPTON. And when you looked at all the options that you considered, what was the one that was the first—what was the priority order that you came up with in terms of where you thought we—what we ought to do to reform Medicare?

Mr. BOWLES. We did not prioritize outside of a 10-year window. We said that drastic steps are going to be taken, those drastic steps must include looking at things like Alice and Paul's premium support plan, it has to look at a robust public option, it has to look at things like block granting Medicaid to the States, it has to look at things like a single payer plan, it has got to look at things like raising the eligibility age for Medicare. That is what we—those are the options we saw that would have to be considered if, in fact, you can't slow the rate of growth to GDP plus 1.

Chairman HENSARLING. Before yielding to the next panel member, Senator Simpson, I think I have been informed that you have to depart in 20 minutes, if that is——

Mr. SIMPSON. Mr. Co-Chairman, I could wait a few minutes after that. I have to get to Dulles to catch a 5:30 flight to Denver so I can get out of town before they find out I have been here.

Chairman HENSARLING. Well, certainly Senator, we sincerely appreciate your participation today, and you will be excused from the panel whenever you need to depart.

Mr. SIMPSON. Let me share with the co-chairs that Erskine Bowles has a remarkable thing to present to you, and if I do have to leave early, I would have given him my time. It is very important that you hear what I think is a solution for you that only he, in his brightness, can propose. You can do anything you want with it, but I think it will get you somewhere where we think you want to get, and Erskine, as I say, if I leave, whatever time you would have allowed to me, but I want to hear from my colleague who came to the Senate when I did, Max, and I will stick around to about 25 or 20 of. Thank you so much.

Chairman HENSARLING. Thank you, Senator, and the co-chair notes that Mr. Bowles now has your proxy.

Mr. SIMPSON. Yes, he does.

Chairman HENSARLING. And the co-chair will yield to the gentleman from Montana, Senator Baucus.

Senator BAUCUS. Thank you, Congressman Hensarling. Everyone wants to reform the Tax Code. I don't know anyone who doesn't. But it is in the eyes of the beholder, what is reform to one might not be reform to the other. You have mentioned the $1.1 trillion in tax expenditures. I think it is important for everyone to know that only about $200 billion of those are itemized deductions. The rest are other tax expenditures, which include the employer-provided health insurance, for example, the retirement income provisions, R&D tax credit, there is a whole host of others in addition to itemized deductions. So if the proposal is to repeal them all in return for lower rates and deficit reduction, people have to realize what that means. A lot of people have relied on those provisions, employees have because that is in-kind income that is not taxed generally, as well as the R&D tax credit to make America strong, and retirement provisions so people can save for the future.

Now, the question that comes to my mind is how quickly do you recommend we tackle all of that? We have a November 23rd deadline, and I think one of you suggested, I think it was Mr. Bowles, you suggested that this be delegated to maybe the tax writing committees so that we do tax reform with some kind of a kicker at the end, penalty if the committees in the Congress don't act, et cetera. I would like you to comment on that. I am also waiting for the Bowles solution at the end of this presentation. I hope it includes something that addresses what I am talking about.

Address revenue. When you gave your presentation, Mr. Bowles, I might say we are all big fans of all four of you. You have worked so hard. When each of the four of you were speaking, you could hear a pin drop. You spent so much time on this subject and so conscientiously, so thoughtfully, people know that. But when you, Mr. Bowles, mentioned one of your four principles, as I recall, one of them was tax reform, but you didn't say much about revenue, how you raise revenue.

My understanding is that the Commission suggested something in the neighborhood, I have forgotten exactly what it was, maybe a trillion dollars in new revenue to be offset with the spending cuts, and is that true? It is my understanding that you need to make permanent middle income tax cuts but not the upper income. You, in effect, propose raising revenue on the current policy basis of about $1 trillion. Does that sound about right?

Mr. BOWLES. Well, you know, you were on our commission and you attended a few of our meetings, so I think you probably know exactly what we did. What we did was, we did in the baseline extend the Bush tax cuts for everyone except the top 2 percent.

Senator BAUCUS. Right.

Mr. BOWLES. And then we reformed the Tax Code by broadening the base and simplifying the code and by eliminating the tax expenditures in our zero option plan, and in the zero option plan all of the tax expenditures did disappear, and 92 percent of the money went to reduce rates and 8 percent went to reduce the deficit. None of it went to additional spending.

Senator BAUCUS. Right. So I think the answer to Senator Kyl's question would be about $100 billion for deficit reduction; is that correct?

Mr. BOWLES. That is about $100 billion a year approximately.

Senator BAUCUS. How can that be enough revenue when there is such spending cuts recommended in your plan? I think you have a two-to-one ratio of revenue raised to spending cuts.

Mr. BOWLES. I think it was even more than that, Senator. I think it was, depending on how you counted, we had about a trillion dollars worth of additional revenue coming in, and we had about $3 billion worth of spending cuts, and we were working——

Senator BAUCUS. $3 trillion.

Mr. BOWLES. Excuse me?

Senator BAUCUS. Trillion.

Mr. BOWLES. Trillion, excuse me. And we were working towards that number. We were trying to get it to be no more than one-third revenue and two-thirds spending cuts, and we tried to get it to be one-quarter and three-quarters.

Senator BAUCUS. Going back to my first question, do you recommend that we here try to enact all those, cut all those tax expenditures and set rates or delegate it to the tax writing committees?

Mr. BOWLES. Well, we do recommend that you delegate it to the tax writing committees and set up a framework in this Commission. I don't think you can possibly rewrite the tax law between now and November 23rd and get it scored nor do I think you can rewrite the entitlement legislation and get it scored by November 23rd, but you can provide instructions to the appropriate committees.

Senator BAUCUS. To raise how much revenue?

Mr. BOWLES. To raise about a trillion dollars worth of revenues.

Senator BAUCUS. Which is included in the reform with broadening the base and lowering the rates?

Mr. BOWLES. Yes.

Mr. DOMENICI. I wonder if you would yield to me for one minute?

Mr. BOWLES. Sure.

Mr. DOMENICI. Mr. Chairman, could I just offer a suggestion?

Senator BAUCUS. Certainly.

Mr. DOMENICI. We felt ourselves extremely confronted by the problem of shortness of time for such a big job of reforming the Tax Code. Some of us were here when Bob Packwood was the chairman in the Senate and that effort took place. It took much longer than you need, but it took 2 or 3 years, 2½, 3 years or more. What we did in our testimony and what we have sent to you in a packet is we have taken Section 404 of the law that created you, which is a section that we think intentionally gave you an extreme amount of authority and more flexibility than we have been talking about, and that flexibility we think permits you to set up a direction with specific things you asked the tax writing committee to do, and that they have to do it by a date certain, which could be 3 months from now, 4 months.

Senator BAUCUS. I appreciate that.

Mr. DOMENICI. You would go to the committees. It is not reconciliation. It is an instruction.

Senator BAUCUS. We want tax reform in the worst way, all of us do. We are trying to figure out the best process and the best way to do it.

Second, I would like to ask about defense spending. It is my understanding that the Fiscal Commission recommended roughly $800 billion in defense cuts. When I compare that with the sequestration, which is about $800 billion, a little bit more, not much, the Budget Control Act in August cut about 350, referring to some accounting. Does that mean that you suggest another $450 billion in defense cuts?

Mr. BOWLES. We recommended about $1.7 trillion worth of discretionary cuts in outlays. It was about $2 trillion in budget authority from the President's proposed discretionary budget. I think he proposed, Senator Baucus, $11.7 trillion in discretionary spending. We proposed to cut it to $9.7 trillion, and the cost of the way the budget authority plays out slower in the form of outlays, it worked out to about $1.7 trillion. We said that should be split proportionally between security and non-security spending. We also recommended that there be a firewall between security and non-security spending over a period of time so that the future Congresses wouldn't come back and load it all up on the nondefense side and not on the defense side.

Senator BAUCUS. Right, right. In the same vein I think the Commission recommended a cap on something called Overseas Contingent Operations.

Mr. BOWLES. Yes, we did.

Senator BAUCUS. There is currently not a cap; is that right?

Mr. BOWLES. [Witness nods.]

Senator BAUCUS. Isn't it true—you may not know this; you probably do—that the Appropriations Committee transferred $9 billion over to Overseas Contingent Operations to escape the limitation?

Mr. BOWLES. I don't know about that.

Senator BAUCUS. That is going on. So you therefore would suggest a cap to help minimize that? I think your cap is $50 billion?

Mr. BOWLES. We were trying to keep the OCO from being a slush fund.

Senator BAUCUS. Thank you. That is what I am getting at.

Yes, Alan?

Mr. SIMPSON. May I say that whatever you do, and that will be so appropriate, just do a plan. You don't have to worry about, you know, who is doing this or the timetable and so on because let me tell you why the rating agencies don't mess with Germany or France or Great Britain, because each of those countries have a plan. All these people are waiting for is a plan. You can decide how many teeth you want to put in the jaw, but just do a plan, and you will see dramatic effects around the world with the rating agencies.

Senator BAUCUS. I agree with you very much. One question on the premium support, we don't have much time here. A concern some have is this, that with the election, to put it in rough terms, it would be a death spiral. That is that people currently on, the insurance companies will package sales of policies to the most healthy, so the most healthy people will buy these new policies, leaving the less healthy in Medicare, and the more that happens, the more the sicker people are in Medicare, so Medicare, the more it happens, Medicare costs just go up, up, up because the sickest are there. I am sure it is something you gave a lot of thought to. But some have raised this question. I am curious.

Dr. RIVLIN. Some have raised it, but we don't think it is true of our plan. We think we have avoided that possibility by the rules that we put in, any plan on the exchange would have to accept anybody, and they would be compensated on a risk-adjusted basis. I mean, they got more for people who are older and sicker, therefore they have no incentive to not serve those people.

Senator BAUCUS. Again, I just want to thank you all very much. You have offered a tremendous contribution to this country, all of you. Thank you.

Chairman HENSARLING. The time of the gentleman has expired. The co-chair now recognizes the gentleman from Ohio, Senator Portman.

Senator PORTMAN. Thank you, Mr. Chairman, and thank you to the four patriots who are sitting before us, trying to avoid what Erskine Bowles talked about today and in the Budget Committee testimony as the most predictable economic crisis our country has ever faced, and I appreciate the discussion today. We talked about a lot of the same issues that this group of 12 has been grappling with, revenues, of course, but also spending.

I would like to focus, if I could, on some of the issues that we have talked about, but maybe with a little different angle. If you wouldn't mind putting up that Bipartisan Policy Center chart, again, whoever is in charge of the charts, that is the one that Senator Domenici asked to be put up earlier. This is the chart that shows that health care spending as a percent of our GDP is set to just about double in the next 25 years. So just take my word for it, you don't need to see it; no, if you guys can put that chart up, I would appreciate it because it is the backdrop to this question.

Erskine Bowles said current benefits encourage overutilization. He talked about some of the things that could be done, including higher co-pays, higher premiums, talked about part A and part B being combined, having a single deductible that is a little higher. He also said that in the Simpson-Bowles proposal that you all recommended reducing—there it is—reducing health care spending over a 10-year period by $500 billion, and I assume to Senator Simpson and Mr. Bowles that that refers to the GDP plus 1, that is what that would mean, $500 billion, given this enormous growth or, to use your words, unsustainable growth in health care expenses.

And let me ask you about a couple of ways to get there that we haven't talked about yet. One is means testing. It seems to me this is one where Republicans and Democrats alike ought to be able to come together. I could give you some interesting statistics, a two-earner couple retiring today will pay about $119,000 in lifetime Medicare taxes and receive about $357,000 in lifetime Medicare benefits. That is 119 in taxes for 357 in benefits, which goes to the advertisement that you talked about, Al. So that is about three bucks in benefits for every dollar in taxes. If you multiply this by the 77 million retiring baby boomers, it is not hard to see why we have an unsustainable program.

Now, we can talk about this in terms of being sure, as Dr. Rivlin just said, that those at the lower end of the income scale are taken care of, but at the same time I think it is difficult to justify giving upper income seniors benefits that so far exceed what they paid into the system. Can you all just comment on that? We haven't talked about that specifically. How do you feel about means testing, particularly on the part B and part D premiums?

Mr. SIMPSON. Well, you have to, you follow the nomenclature here, you never want to use the word "mean" in anything especially. You call it affluence testing, and then you get juice, and that is what you should do. You are going to have to start affluence testing some of these benefits. There is no possibility of people who, as I say, literally, and you know them in your own community, who use these systems and pay nothing.

Senator PORTMAN. How about co-pays?

Mr. SIMPSON. Co-pays have to go up, and you have to affluence test in that. These are my personal views.

Senator PORTMAN. Could we see a show of hands from the panel because the photographers love this, how many are for affluence testing?

Mr. SIMPSON. It would be when they ask the Republicans for nine bucks worth of spending and one buck worth of revenue, and all hands shot up like robots. You don't want to get into that.

Senator PORTMAN. But this worked.

Mr. SIMPSON. I do favor that affluence testing, I think I always talked about it, Bob Kerry and I have talked about it, Max remembers Bob Kerry and I and Danforth and Bradley were all involved in that years ago when we were here. You have to start, and it will be called un-American, cruel, evil, breaking the contract, I can hear the music and the violins in the back already, and it won't work anymore.

Senator PORTMAN. Okay. Let me go to a tougher one. I don't know if we have——

Dr. RIVLIN. Can I chime in on that? We already do have in the part B premiums some——

Senator PORTMAN. And in part D now.

Dr. RIVLIN. And part D, and we are certainly in favor of increasing that.

Senator PORTMAN. Okay. Erskine, you talked a little bit about, again, some other ideas, and I am going to put you on the spot here, my friend, because one was raising the age. How do you feel about raising the eligibility age, given the statistics on longevity? Eligibility age on Medicare I am talking about.

Mr. BOWLES. We actually did not have that in our plan. As I have thought about it since that time, you know, under the Affordable Health Care Act, we provide subsidies for people who have really chronic illnesses and for people who have limited incomes to get so that they can afford health care insurance in the private sector, and that didn't exist before the Affordable Health Care Act, and that means that people 65, 66, 67 would still be able to get health care insurance.

So as I think about it, I could support raising the eligibility age for Medicare since we have other coverage available through the Affordable Health Care Act.

Senator PORTMAN. Let's go to tax reform for a second if I could. All of you are talking about broadening the base, and Chairman Baucus, and I am sure Chairman Camp is going to address this, too, something they are very interested in, simplifying the code, being able to do so by reducing marginal rates and getting rid of some of the underbrush. One thing we haven't talked about is corporate reform. As you all know, we have the second highest corporate tax rate among our trading partners. Japan is slightly higher, and they are intending to take theirs down. The average of all the developed countries, the OECD countries, is 26 percent, we are at 35 percent, but in fact we are not because you have to add State taxes on to that, and the average is about 6 percent, which happens to be Ohio's rate, so you are talking about 41 percent, and we do not have a territorial system, we have a worldwide system, which also puts us at a disadvantage, we are told, by all of our companies.

Could I see a show of hands on this, do you all support getting the corporate rate down to a competitive level? I would define that as 25, 26 percent and territoriality, does everybody agree with that?

Senator PORTMAN. Oh, Alice. I almost got Alice.

Dr. RIVLIN. Well, if you are pinning us down to a rate, I mean, we did take the rate down to 28 in ours.

And, actually, we didn't do territoriality. And the reason was interesting. Simpson-Bowles had strong representation from big, multinational corporations on it. They spoke very eloquently for territoriality. Our business representation was more small business. They were not enthusiastic about territoriality. So we left it out.

Mr. BOWLES. Yeah, we did. We took the corporate rate to 26 percent, and we went to a territorial system to pay for it.

Senator PORTMAN. Pete?

Mr. DOMENICI. I support ours, the one we have been describing. We didn't come down as far as them, but 28 is ours.

I think the problem we have with the public on that is it is discussed in isolation by the commentators. They just say we are lowering taxes on fat cats, corporations. But when it is part of an overall plan, they got a big——

Senator PORTMAN. Yeah, I am talking about not lowering the tax, so it would be revenue-neutral, so there would be no reduction in the taxation. In fact, you would get growth from that, based on all the economic analysis that we have seen, which would add more revenue that was not revenue from increasing taxes but revenue from growth and other feedback effects.

Mr. DOMENICI. I don't disagree. I was just giving you an explanation that I have heard.

Senator PORTMAN. Yeah. I appreciate it.

With regard to balance, because that has come up here—the co-chair talked about balance, you all talked about ratios and balances—what is the right balance? I think, first, can—you talked about this earlier, in terms of where you all were headed and where you ended up. Could you or Senator Simpson give us a sense of what you believe is the right balance here between revenue that is generated, again, through tax reform, but new revenue, on the one hand, and, on the other hand, reductions in spending? What is the right balance?

Mr. BOWLES. We thought it was no less than two-thirds, and we worked toward three-quarters coming from spending, as opposed to one-quarter or one-third coming from revenue. If you look at the projections for 2020, it had spending, I think, at about 25 percent and revenue at 19 percent. And we didn't want to see revenue go above 21 percent. And, obviously, we wanted to see if we could drive spending down to where revenue was so we could balance the budget at some point in time.

Senator PORTMAN. Yeah. Well, that is interesting, because you are right, you know, we are now at about a historical average of about 18.4 percent on revenue. And we are lower now with the recession, but even under CBO's statistics showing that the tax cuts would all continue, we get back up to that 18 percent in the next several years.

One final—well, I see my time has expired. Listen, again, I want to thank you all for your help today and the help you have given us up to this point, all of you who have made contributions to our efforts, both individually and as part of your groups. And we are going to need your help going forward. Thank you.

Chairman HENSARLING. The time of the gentleman has expired.

The co-chair now recognizes the gentleman from South Carolina, Congressman Clyburn.

Representative CLYBURN. Thank you very much, Mr. Chairman.

Let me add my voice of thank-yous to all four of our panelists here today, and thank them so much for their service.

I want to start with a statement. I have asked—and it has been put up—for a chart to be put up here, looking at a bar graph that I suspect a lot of us have seen in the last week or so and we talked about when Dr. Elmendorf was before this committee. It shows the widening wealth gap that is existing within our country today, and it covers basically the last 30 years.

Now, we have 3,143 counties in the United States. Of those 3,143 counties, 474 of them, 15 percent of those counties, more than 20 percent of their citizens have been living beneath the poverty level for the last 30 years.

And it is kind of interesting because I didn't think about this through the weekend because, about several months ago, I joined with Congresswoman Emerson on trying to focus on these counties and trying to direct resources to these counties. Back when we did the American Recovery and Reinvestment Act, the stimulus bill, in the rural development section of that bill we were successful in getting that bill to focus on these counties by directing the expenditure of at least 10 percent of those funds into those counties where 20 percent or more have been beneath the poverty level for the last 30 years. So when this report came out from CBO a couple weeks ago, it focused my attention once again to those communities.

Now, when I first came on this panel, I said that I wanted to focus on the human side of this deficit. So what I would like to ask today is whether or not it is feasible to do $1.5 trillion reduction in deficit by cuts only. What will that do to that bottom 20 percent that has seen only 18 percent growth in their income over the last 30 years and those communities where 20 percent or more of their population have been beneath the poverty level for the last 30 years? What would it do to those communities and those people if we were to reduce this deficit only by cuts that have been proposed?

I would like to hear from all four of you on that.

Mr. BOWLES. Yeah, I am delighted to go first on that.

As you know, Mr. Clyburn, if you go east of I–90 and you are in North Carolina, we have more counties that fall into that category than any other place in the Union. If that part of the North Carolina was a State by itself, it would be the poorest state in the Union. So, as you know, I had many of our universities, from Fayetteville State to Elizabeth City State, that operated and served the people in those communities.

I think if you think about what you have already done, if you look at the continuing resolution, you took about $400 billion of cuts through the continuing resolution. And then if you think about—I always think about what you all are working on now with the Budget Control Act in two parts, and the first part was $900 billion in cuts. So you had another $900 billion in cuts that have already been done.

So you have done about $1.3 trillion worth of cuts already before you guys start on what you are doing.

Representative CLYBURN. Right.

Mr. BOWLES. I have always thought it has to be some combination of revenue and cuts in order to get to the $4 trillion number that we focused on. I do think it is important for all of you to think about the fact that these deficits are just eating the budget alive. And they don't leave any money left over to do the kind of economic development work in these poor counties that you want to see done if these deficits continue to grow and interest on the deficits continue to occur.

What we tried do was to make sure in the analysis, in the plan that we put forward that we didn't make any cuts in the income support programs like SSI and food stamps and workers' compensation. In addition, we tried to make sure that on things like Social Security that we actually upped the minimum payment to 125 percent of poverty to help those people who really needed it. And we gave people a 1 percent bump-up per year between 81 and 86, because that is when every Democrat and Republican economist that came to see us said that is when people need it the most.

So we tried to be sensitive to those people that were most disadvantaged while we did make the kind of cuts we had to make in order to put our fiscal house in order.

Mr. SIMPSON. We have enjoyed our time with you during our work. And you have been very cordial and listened to us, and I appreciate that deeply.

Representative CLYBURN. Thank you.

Mr. SIMPSON. The irony to me is that if we don't get there and the strike comes, the tipping point—Dick Durbin always asks, where is the tipping point? I don't know where it was, but I do know that it will come swiftly. And it will come by the ratings and the markets. It won't come by anything that any chart has ever disclosed before.

And, at that point in time, interest rates will go up and inflation will go up. And the very people who will be hurt the very worst in that procedure are the very people you speak of with such passion. This is a tremendous irony to me. By doing little or nothing and the tipping point comes, the little guy is going to get hammered worse than ever he is or she is now. That is the irony—the strange, hideous irony.

Representative CLYBURN. That is true, Senator. But wouldn't you say that, if we were do it, let's do a $1.5 trillion deficit reduction and let's do it on the backs of those same people, then what happens to that chart in the next 30 years, where we have a 275 percent increase in income for those people who are in the upper 1 percent and if you are in the upper quintile you saw an increase of around 56 percent and the lower quintile only 18 percent?

So let's just say, let's do it. Let's cut the deficit by $1.5 trillion. Let's do it by cutting Medicare, Medicaid, cutting Pell Grants, cutting education, cutting health care. And we will have saved the markets, but what will we have done to these 474 communities? That is my question.

Dr. RIVLIN. I think that is not a question that we should answer, because you shouldn't do that.

And there are two points. And I think we are all making the same two points. One is, we need to cut the deficits, but not by hurting vulnerable people. You should avoid doing that. And, secondly, that the importance of avoiding a double-dip recession and a lost decade of growth is extreme and will hurt those people most if you don't avoid it.

Mr. DOMENICI. I am the last here, and you have heard almost anything humankind can think of, but I would suggest to you that the answers that were given are really relevant and important.

And one of the reasons that our group did not get as big of reductions in appropriated accounts as other plans was because we came upon the idea that we were going to have to come up with some revenue and we ought to have a budget that was understanding in this area, or it would, quite properly, be attacked with equal vigor to destroy it as we were trying to create a country that was strong again. And so we did take care of the problem you talk about.

But I would tell you from my own experience as I leave the scene, one time I asked a very wise man, "What do we do to help poverty?" And the person said, "I can tell you in one word." And I thought, you must have direct ties with the Holy Spirit. And he said, "Educate." He said, "Would you like it again? Educate."

Representative CLYBURN. Absolutely.

Mr. DOMENICI. And that is what he said, is that people must get educated. Well, that won't solve the bread on the table, but any plan you have in mind should obviously look at whether the poor people are getting educated or not.

Representative CLYBURN. I appreciate that.

Mr. DOMENICI. And that is the first step out, has got to be that.

And, secondly, the country has to grow or there is nothing to split, there is nothing to give to our people. So whatever programs you are talking about have to have growth in them. That is why all our tax plans are growth tax plans. Theirs is; ours is. We call it that. And we asked experts, and they say, your tax plan will cause far better growth than the plan we are under now.

That is why we cut corporate taxes. And people shouldn't immediately say, what do you cut the fat cats for? They aren't making as much here to give to our people in wages because they are going elsewhere because our taxes are too high. So it is not what people say. The reality is competition. We can't force them to stay in America if our taxes are too high.

So I think education and a fair tax for corporations belongs on this litany, maybe not first but somewhere.

Chairman HENSARLING. The time of the gentleman has expired.

Representative CLYBURN. Thank you.

Chairman HENSARLING. The co-chair now will recognize the gentleman from Michigan, Congressman Camp. And before I do, I just wish to thank him for arranging for the Joint Select Committee to use the Ways and Means Committee room. And your chair is very comfortable. Thank you.

Representative CAMP. Thank you.

Well, I also want to thank our witnesses for being here and for all of your hard work and your testimony today.

I do have a question. Mr. Bowles, in the Simpson-Bowles plan, you recommended that the United States move to a territorial tax system. And I agree with that recommendation because I think our current system is one that really means that our companies and workers aren't competitive. Do you share that view, and is that why you recommended moving to that system?

Mr. BOWLES. Yes. I have read your—I guess it is what this committee put out, the Ways and Means Committee put out, and I was very much in favor of what you put out.

Representative CAMP. Do you believe that—in our proposal or draft discussion we have out there, there are ways to move to a territorial system that does not create incentives for companies and employers to move jobs to other parts of the world, or their investment or their R&D. But, also, I think it is possible to craft a plan that could get that policy wrong.

In the Commission's meetings, our discussions, you were focused on moving to a territorial plan that did not make our companies less competitive. And do you think that can be done in the context of a revenue-neutral territorial plan?

Mr. BOWLES. Yeah, I do. And I think, you know, if you encourage—if you stay on a worldwide system and you almost force companies to leave those dollars overseas, then, naturally, if they are going to have to pay a big tax on those dollars to bring them back, I think the likelihood is more probable that they are going to create the jobs somewhere else rather than here.

And that is one of the principal reasons I support a territorial system, in addition to the fact that everybody else in the world has gone to it with the exception of us.

Representative CAMP. You also really recommended a complete overhaul of our Tax Code. And I appreciate the model that you set up, where you tried to lower rates in exchange for doing away with various provisions or exceptions in the Code. And I think that really has shifted the debate on what tax reform might mean.

Your reform proposal would raise revenue compared to the current policy baseline, but you didn't do it by raising taxes. A lot of people get those two things confused. And why did you choose that route of raising revenue really through reform rather than imposing new taxes?

Mr. BOWLES. Because I felt like, based on my experience in the business world and the economists that I talked to, that it would create dynamic growth in this country and create jobs and opportunities for people. And I felt it just made sense to get the spending out of the Tax Code and to use that money more efficiently, more effectively by lowering rates and reducing the deficit.

Representative CAMP. All right. Thank you.

Dr. Rivlin and Senator Domenici, in your plan, you have had the government's share of our GDP around 21 percent, I believe. Is that correct?

Dr. RIVLIN. Yes.

Representative CAMP. And that is basically $1 out of every $5 of our economy would come to Washington, D.C. And that is more than the highest levels of revenue we have seen in the history of the Nation. And I think there has been only one time where the government's take has really gotten anywhere close to that level, and that was during the Internet bubble because there were enormous capital-gains revenues associated with that.

Did you perform an analysis of the impact on the economy and on job creation of having government's revenue of GDP reach that level?

Dr. RIVLIN. No, not ourselves. We examined other people's research on this. I don't read the record as having much evidence at all, of a connection between the exact proportion of the Federal Government's revenue and economic growth.

The reason ours went up was, as I have stated earlier in the hearing, we didn't see how, in this very new situation of a much older population and the tsunami of the baby boom, we didn't see how we could fulfill our obligations to those people, and perform the other services of government without having the government in that range.

It has been there before; it is not a disaster. This is not taking on new government responsibilities. It is just saying, we have a lot more older people and we have to take care of them. And that is going to mean slightly higher government spending than we had in the days when the population was a lot younger.

Representative CAMP. Senator?

Mr. DOMENICI. Yes. Let me just say, I, too, in my past life, have used percentages like that. I have learned that on many of them there is no reality attached to the number. Nobody can tell you that 20 percent, 19 percent is better than 19.5 or 20.6. If you have the rest of the policies right, things will—in our kind of economy, we will get growth.

The problem we have in this country has been expressed over and over here today, and that is that the population is growing older, the population has less workers per retiree, and so you have a—when we looked at the 19 or 18.5 that was used as the historically significant number, we didn't have these demographics, we didn't have this kind of problem.

So we solved it by trying our best to use the Tax Code to generate some extra revenue in the manner we have suggested here. And, at the same time, we have taken on the responsibility of some of the programs that are going to sink us if we sit by and say, we have to have 18.5 percent, and that is all on the revenue side, and then what are we going to do about the exploding costs of the programs? And I think we have solved it in a pretty reasonable manner. If you want to just say, let that one go out there, we will fix it someday, we can't fix Medicare to match the 21, much less the 18.5 that was historically right.

So that is my answer. I think there is no absolutely positive evidence that any of these numbers are absolutely right. They are right, they are in the range, but if you do the other policies correct, we will survive with 21 percent, I am sure.

Representative CAMP. You also had two new tax structures in your proposal. One was what you described as a debt-reduction sales tax, or what most people would consider to be the value-added tax. The other was the tax on sugared drinks, or beverages.

Did you do an analysis about the cost of those two new tax structures, the implementation of two new tax structures on our economy and what that might mean?

Dr. RIVLIN. Well, you are right that we did have the debt-reduction sales tax. We didn't call it a VAT, but you are right, it is analogous to that. I think that the Senator and I and the members of the group all believed that it would be sensible for the United States to move part of its tax burden off the income tax and onto a broad-based consumption tax. But this is not the moment to do that. And we realized that and eventually took it out, though we still believe in it, and revamped our income tax proposals to make up part of the lost revenue.

The sugared drinks, you know, that is not going to change the economy. Whether it, at the margin, discourages people from drinking too much soda, I don't know. But we had some sentiment for doing it.

Mr. DOMENICI. I would say, on the last one, sir, we didn't look at the economic significance of it. You have been chairman of a committee, and I understand you are now of a very significant—sometimes you are just outvoted and you have to do things that aren't necessarily the greatest.

Representative CAMP. Yeah, I get that part.

Mr. DOMENICI. You got that.

Representative CAMP. All right. Thank you. Thank you very much.

I yield back.

Chairman HENSARLING. The gentleman yields back.

The co-chair now recognizes the gentleman from Massachusetts, Senator Kerry.

Senator KERRY. Thank you very much, Mr. Co-Chair.

First of all, I want to thank each of you for your extraordinary service, not just in this effort, which is important, but over the years. And we are particularly appreciative to this contribution to the dialogue. And I hope it will be a contribution to more than a dialogue, but to a result from this committee.

I just want to spend a few moments on some of the context that brings us here.

Administrator Bowles, you opened up with a comment that caught my attention—two comments. One, you said, this is the most predictable economic crisis in history that we are looking at coming at us, even as you pegged the minimum figure of $4 trillion, which is what you think we ought to do. But then you said you are worried that you are going to fail. And I want you to speak to that for a moment.

Mr. BOWLES. You all have done a great job of stopping the leaks coming out of your committee for an extended period of time, but over recent days I have been able to put together some of the proposals that you all are considering. And I have also listened to some of the back-and-forth that has been in the press.

And I have heard people talk about simply settling for $1.2 trillion worth of deficit reduction, maybe $1.5 trillion, but more of the talk is at $1.2 trillion; doing it across the board, which is never the smart way to make any kind of—to control any of your budgets in any way, shape, form, or fashion. And I have even heard talk that if you end up doing $600 billion out of defense and $600 billion out of nondefense, that the day after the sequester takes place that you will have people in the House and the Senate be working to get around the sequester.

I think that would be disastrous. I think people would look at this country and say, you guys can't govern. I think people would look at it and say, you know what, they are really not going to stand up to their long-term fiscal problems, and this is not going to be a powerful country in the future. And they would think that we were well on our way to becoming a second-rate power. I think it would be a disaster.

Senator KERRY. So I want to sort of build on that a little bit. We all know that the figure we should hit in order to stabilize the debt, which is the mission and ought to be the mission of the Congress, is $4 trillion.

What is the impact in the marketplace, what would the impact be on a discounting of our debt, a write-down, if we hit $1.2 trillion or $1.5 trillion? Aren't we going to just be back here almost immediately with the very same issues sitting on the table?

Mr. BOWLES. You could lose the $1.2 trillion to $1.5 trillion by an increase in interest rates back to the normal rate very quickly. You wouldn't be accomplishing very much if you did that.

And plus, you know, the effect it would have on how people would look at this country would really be devastating. I can tell you, when we went through this whole debt default fiasco before August, I can tell you, globally, countries lost a lot of respect for America, and they lost confidence in us that we would really stand up and address our long-term problems.

Senator KERRY. Now, Pete, I am sorry that Al had to leave, but you and I had the great pleasure of working together on a number of different issues, and I trust your judgment. And while we are not wearing partisan hats, hopefully, here, you are a Republican. And I would like you to share with us, sort of, your perception as a long-time legislator.

When, in your memory, has a committee in Congress ever had the right to put together a proposal that would be voted on by expedited procedure in both Houses of Congress with a 51-vote majority without amendment?

Mr. DOMENICI. The answer is never.

But I would tell you, when we passed effectively in the Senate the bill that created the Budget Committee, it was an impoundment and budget act, as you recall. It was to deauthorize the authority of the President to impound and, at the same time, to create a Budget Committee. Senator Robert Byrd, the expert extraordinary on the Senate, spent weeks on end trying to figure out a way that you could assure the passage of bills that pertained to the budget and not destroy the filibuster rule. And, in the end, he quietly gave in.

And the Budget Act, if you go look at it, it is a big, thick bill, but, nonetheless, if you read it and do what I did, I decided that it meant that I could take a reconciliation bill to the floor of the Senate and it could not be filibustered. And I defeated Robert Byrd because his own writing said he had found a way, without changing the rules of the Senate, to get around filibuster and give authority to a committee.

So we gave the Budget Committee in the Senate the authority to act without filibuster. But nothing as powerful as this committee.

Senator KERRY. And what would be the implication—I would like to ask all three of you. You answered this, to some degree.

Director Rivlin, you have headed up the CBO, you have headed up the OMB, as well. What would be the implications, in your mind, of the United States of America not meeting what everybody understands is the financial challenge facing us, sort of, stabilizing the debt and beginning to get on a long-term fiscal path? How would the world view this, particularly given the fragility of Europe right now and their efforts on Greece, Italy, Spain, et cetera?

Dr. RIVLIN. I think it could be devastating. I agree with Erskine and would be even stronger. I think we could face a long period of stagnant growth, another recession, which would be worse than the one we are slowly climbing out of.

It is very hard to predict when this might happen or what the course might be. But, certainly, in the last few months, we have seen dramatically in Europe that sovereign debt of quite solid-seeming countries can go down very fast. And that could happen to us. And we could just lose the confidence of our trading partners and ourselves.

I think the problem is, if we are seen by our own citizens as not being able to face up to problems and solve them, we are in deep trouble.

Senator KERRY. And, importantly—I think it has been put on the table here clearly today, and I am sort of trying to reiterate this because I think it is important—it is possible to put revenue on the table to the tune of $1 trillion-plus, whatever, with tax reform, is it not? You do not have to raise the tax rates. In fact, you could do the tax reform with specific instructions to the tax committees to hold the rates down, lower the rates, get a lower range, broaden the base, correct?

Dr. RIVLIN. Right.

Mr. DOMENICI. We actually went out of our way to get some experts together, the best experts in this town—and I think we know who they are—and asked them, does that section 404 give the kind of authority that you just alluded to, to direct to the committees that they perform the following and report it back? And that bill would carry with it in the Senate the same prerogatives that the original bill carried when you were created.

Senator KERRY. Now, Pete, you and I met, and we talked about your concept with respect to health reform. And I appreciate the contribution of it, and I have been trying to work through how we might be able to do some of those things. There are some issues, I think, about how you guarantee the coordination of the lowest health-care plan and still get coverage in certain areas, but I don't want to get stuck on that for the moment. What I want to do is, sort of, deal with the bigger issue here.

I assume all of you would agree that you can do structural reform in Medicare, in the entitlements, that is not necessarily just the premium support approach. Is that accurate?

Mr. DOMENICI. That is accurate.

Senator KERRY. Director Rivlin?

Dr. RIVLIN. Oh, certainly. There are several approaches. We like that one.

Senator KERRY. And, for instance, the age thing that Senator Portman asked about, that is structural reform, isn't it?

Dr. RIVLIN. I actually wouldn't think of raising the age as structural reform.

Senator KERRY. What would you think of? Give us some thoughts about structural reform that you think would conceivably alter it, whether it is dual-eligible, Part A, Part B. Are there other components? Or, how about this, that you begin to move the entire system off of fee-for-service where possible, where it works you would leave it, but you move into a value-based payment system?

Dr. RIVLIN. Yes. And that is roughly what we are proposing.

Mr. BOWLES. Senator Kerry, I have a lot of opinions about health care. I think the current system doesn't make any sense, to pay twice as much as any other developed country for health care and have our results rank somewhere between 25th and 50th. You know, we have 50 million, roughly, people who don't have health-care insurance. You know, I just ran the public health-care system in North Carolina; it reports to the president of the university. And if you don't think those 50 million people get health care, you are crazy. They get health care, they just get it in the emergency room at five to seven times the cost it would be in the doctor's office. And that cost doesn't disappear; it just gets cost-shifted to those of us who have health-care insurance and in the form of higher taxes.

You know, we have got to have real structural reform in health care. I believe all people ought to have health care, but I don't think anybody should get, on the government's checkbook or the taxpayers' checkbook, a Cadillac plan. I don't think anybody ought to get first-dollar coverage, because I think we ought to make sure that people have skin in the game.

And if you are going to have everybody have coverage, then you have to have everybody have a medical home. And if everybody is going to have to have a medical home, then you darn well got to make sure that education institutions like mine are producing more primary-care doctors and more nurse practitioners and more physician's assistants and not so many specialists.

I think if you want everybody to have prescription drugs, then I don't know why in the world you wouldn't have Medicare negotiate with the drug companies for prescription drugs if the taxpayers are going to pay for them. And I don't know why anybody who was getting drugs from the taxpayers ought not to have generic drugs.

If you don't think that hospitals and doctors practice defensive medicine, you are absolutely crazy. They do. So we have to have some kind of real tort reform.

And you are absolutely right, we have to go to paying for quality, not quantity.

And at the end of the day, you know, nobody likes this, but without talking about death panels and that kind of crazy stuff, you are going to have to do something about the end-of-life scenario.

Those kinds of things have to be done if you are really going to address health care.

Senator KERRY. Well, I thank you all.

And I apologize to the chairman——

Chairman HENSARLING. The time of the gentleman has expired.

The co-chair now recognizes the gentleman from Pennsylvania, Senator Toomey.

Senator TOOMEY. Thank you very much, Mr. Co-Chair.

And I also want to add my voice in thanks to the folks who have come here today for the work you have done. It has been enormously helpful.

Let me touch on a couple of the issues and develop a few a little bit further, if I could.

One, obviously, we all know, as a given, that the Federal revenue is ultimately a function of our economy. But I think it is worth noting, and I think you will all agree, that the growth in Federal revenue is related to the growth of the economy, but, in fact, Federal revenue will grow faster, as long as the economy is growing, than the growth of the economy.

And since Dr. Rivlin is the professional economist on the panel, I wonder if you would just confirm that, as a general rule, if we have strong economic growth, we will have even faster Federal revenue growth.

Dr. RIVLIN. That used to be true, Senator, before we indexed the tax system. It is much less true now. If you have strong growth, Federal revenue will go up a little faster than the economy, not much. We gave away that tool, actually, with the indexing.

Senator TOOMEY. All right. So we could have a discussion about how much that magnitude is, but, even now, there is some additional growth faster than GDP growth.

One of the things that came out from our discussion with CBO about this is that one-tenth of 1 percent of additional GDP growth, on average, over 10 years they estimate results in about $300 billion of additional revenue to the government. Now, this is not perfectly linear, and I understand that, but, very roughly, if that were to be roughly true, less than half a percent of average greater economic growth would result in, coincidentally, about $1.2 trillion, which is the statutory goal here. I am not suggesting that that is an alternative to our doing the work that we do, but I think it underscores how important it is that whatever we do attempts to create an environment to maximize growth.

My own view from the beginning has been that the most constructive thing we can do to maximize economic growth is major reform of both the corporate and the individual tax codes. I don't think there is any dispute about that. But I wanted to drill down a little bit.

For instance, if we—there are many approaches one could take. Let's look at the individual side for a moment. And for the sake of argument, if we were to reduce the value of all the deductions that are currently available to individuals and we had an equivalent reduction in rates, for sake of argument, everybody agrees that would be very pro-growth. Is that right? There is a consensus on that?

My understanding, from both Mr. Bowles and Senator Simpson, was that when you folks looked at this exercise of reducing deductions and credits and write-offs, lowering rates, you did it with roughly a 10-to-1 ratio. For every dollar that was dedicated to lowering rates, there was a dollar dedicated to deficit. I think you had suggested that it was, like, 92 to 8?

Mr. BOWLES. Yeah, that is correct. Yeah.

Senator TOOMEY. So 10 to 1, 11 to 1, that was about the ratio. Do you recommend that we take an approach like that, where we would, on the individual side, do that kind of simplification, lowering of rates, and have a ratio comparable to that?

Mr. BOWLES. I think you will run into some of the problems that Senator Baucus brought up. That is why we presented two options. If you go with the zero plan and get rid of all of the tax expenditures, then you do create enough resources that you can use only 8 percent of the resources and still generate a trillion dollars' worth of additional revenue that could go to reduce the deficit.

However, if you are going to go back and not get rid of all of these tax expenditures but you are going to keep some of them—like, some of the Democrats will want to keep the Earned Income Tax Credit, they will want to keep the child tax credit, some of you may want to go to a credit for mortgage—to help people with their mortgage debt, some people might want to go to a credit for charitable contributions.

So anything you keep gives you a smaller pie to work with. So if you are still going to come up with a trillion dollars of deficit reduction, then that 1-to-10 ratio won't work anymore.

Senator TOOMEY. Okay.

Does everybody on the panel agree that if any package were to include net tax revenue it ought to come in the context of reform that actually lowers marginal rates?

Dr. RIVLIN. Yes.

Mr. DOMENICI. Yes.

Mr. BOWLES. Yes.

Senator TOOMEY. Okay.

Let me move over to health care for just a second. I am glad, I think, again, that there was a consensus, I think it was unanimous, that it is our health-care costs that is driving the deficit and debt crisis that we have.

It has been my view, and I wonder if anyone disputes this, that, in fact, it is our Medicare plan that essentially drives the entire health-care sector. And while there is, obviously, a significant private-sector component, to a large degree it is a reaction to, and it acts in the context of, what Medicare does. And so Medicare is the real driver of the entire health-care picture.

Do you agree with that?

Mr. DOMENICI. Yes.

Dr. RIVLIN. Yes. And there are instances in which Medicare has actually done significant reforms and the private sector has followed.

Senator TOOMEY. Right.

Mr. BOWLES. And I only agree with part of it. You said that Medicare was the only—I am not sure you said "only," but Medicare is one of the drivers of our deficit problem. It is not the only driver. I think it is the number-one problem——

Senator TOOMEY. What I said was that health care is, and I meant to say is the primary driver.

Mr. BOWLES. Yeah.

Senator TOOMEY. Senator Kerry talked about structural reform. It seems, in my view, meaningful structural reform means getting away from fee-for-service. To me, that is the heart of Medicare, that is the heart of the design. And because we use this terminology and assume that everyone knows it, I will take a crack at describing what I think of as fee-for-service, and tell me if I have characterized it right.

But, essentially, what we have is a committee here in Washington that specifies the price it will pay for every conceivable medical procedure, the circumstances under which it will pay it, the people who are permitted to perform it, where they are allowed to perform it, in which venue. And it is a completely, you know, government-controlled mechanism, which also, by the way, doesn't account for whether the outcome is successful or not and whether the procedure needs to be repeated.

Is that a fair characterization of fee-for-service?

Mr. BOWLES. I think what I said earlier in answer to Senator Kerry was that I think we are going to have to move from paying for quantity to paying for quality. And I think you are saying something very similar.

Senator TOOMEY. Well, I am. I think, at the heart of this, this necessarily creates all kinds of inefficiencies, misallocations, perverse incentives. And the solution has to be to get away from this.

I guess my last question for everybody, are all of you confident that——

Mr. DOMENICI. Before you proceed——

Senator TOOMEY. Senator?

Mr. DOMENICI [continuing]. I did want to make an observation, that we recognized that Medicare had some very significant problems of the type you are alluding to, and that is why we are here suggesting that it be changed.

Senator TOOMEY. Right.

Mr. DOMENICI. At the same time, we have explained why we said, as we move——

Senator TOOMEY. Right.

Mr. DOMENICI [continuing]. We don't move so quickly with getting rid of one and establishing the other that we lose both or lose all reform.

Senator TOOMEY. One of the things that concerns me is that, as long as we leave a significant fee-for-service component in place, I worry about whether the reforms are capable of defeating the mechanism and the misallocations and the, sort of, perverse effects of that fee-for-service.

So I would ask this. Do you think it is possible to devise a plan that would transition completely away from fee-for-service, some kind of premium support model that is defined to ensure that the most vulnerable people have the coverage that they need?

Mr. DOMENICI. Well, I will say, for the time being and for the foreseeable future, it seems to me you cannot do that. You have to go with some transition. You wouldn't get the other done.

That was the question, whether you can get it done. I am not an expert. I didn't sign on for this job to be an expert on Medicare. That is why I don't answer some of your questions. But I am saying, practically, I don't think it could be done now under this circumstance. We have to do something——

Senator TOOMEY. Well, I am not suggesting that so much, but I appreciate the response.

Dr. Rivlin?

Dr. RIVLIN. Well, I agree with the Senator. I think that the idea—we believe that, actually, competition on a well-designed exchange between comprehensive health plans, particularly capitated plans, they would win out in a fair competition.

There are parts of the country, especially rural parts of the country, where it probably isn't feasible right now to do that. And that is why we think there ought to be a transition, and that it is much less scary for seniors to say, "If you like what you have, you can stay with it, but you are going to be offered something which is likely better."

Mr. BOWLES. Yeah. And I would say, if you look at some of the pilot projects in the Affordable Health Care Act, they have some good examples in there of experiments that are going on today to do just what you are talking about.

Senator TOOMEY. All right. Thank you all very much.

Chairman HENSARLING. The gentleman yields back.

The co-chair now recognizes the gentleman from Maryland, Congressman Van Hollen.

Representative VAN HOLLEN. Thank you, Mr. Chairman.

And I want to join my colleagues in thanking all of you for your terrific service to our country in many different capacities.

Mr. Bowles, thank you for recognizing that actions the Congress has already taken to date, including passage of the Budget Control Act, has already achieved projected savings of close to a trillion dollars in discretionary funds, which isn't far from the targets that all of you set in your work, the major difference being you actually had a higher part of that coming from defense cuts. Is that not the case?

Mr. BOWLES. We actually divided ours between security and non-security.

Representative VAN HOLLEN. Right. And so you were at about $1.2 trillion in discretionary. Half of that is $600 billion. I think the figures will show that your proposals took more than has been taken to date from the defense side of the equation.

But I want to—I think many of us view your general approaches here as balanced approaches, balanced frameworks. So I want to put the discretionary piece to the side for a minute because we have come close to achieving, in some cases overachieving, your targets.

In Simpson-Bowles, as you mentioned, Mr. Bowles, you had about $500 billion gross cuts in Medicare and Medicaid. You actually took some savings out of that. Net, it was around $400 billion.

But on the revenue, I just want people to understand, because what you had in both your plans was genuine—what us budget geeks call genuine CBO-, Joint Tax Committee-scorable revenue. And, as you mentioned, Mr. Bowles, your baseline assumed as part of your deficit projections that we would have about $800 billion, which is equivalent to about the amount of money that would be generated from allowing the rates for the folks at the very top to lapse, correct?

Mr. BOWLES. That is absolutely correct.

Representative VAN HOLLEN. That is right. And then on top of that you had proposals, through tax reform and the other things you have talked about, to generate another about $1.2 trillion. Isn't that right?

Mr. BOWLES. Right. We—that is exactly right.

Representative VAN HOLLEN. All right. And so, again, on the Budget Committee, when we are comparing that to what we call the current policy baselines, compared to CBO that is about a $2.1 trillion, $2.2 trillion tax cut compared to current law. Of course it is a—excuse me, revenue increase. Compared to current law, it is a tax break.

And looking at your testimony, Dr. Rivlin and Senator Domenici, you come in about the same place, $2.2 trillion on a current law baseline, correct?

Mr. DOMENICI. Right.

Dr. RIVLIN. Right.

Representative VAN HOLLEN. All right. So let me just ask one other question with respect to tax reform. I take it, from looking at both your reports, that you would want tax reform to be done in a way that maintains at least the current progressivity of the Tax Code. Is that correct?

Mr. BOWLES. Yes.

Mr. DOMENICI. We worked very hard to do that in ours.

Representative VAN HOLLEN. Thank you.

Dr. RIVLIN. Ours is actually slightly more progressive than the current.

Representative VAN HOLLEN. Right. So at least the current progressivity of the Tax Code.

Now, you have both, in your written testimony, suggested we may want do two-step processes, downpayment and then something else. Dr. Rivlin, Senator Domenici, you specifically say, as part of that downpayment, you would include about $450 billion of what you call tax expenditure savings.

I assume, therefore, that you see that as something you could do for deficit-reduction purposes, not necessarily at the same time as tax reform. And I think, if I look at the ones you have picked out, you think that they could be what we call rifle shots. Is that right?

Dr. RIVLIN. Right. But it should be consistent with—our notion is you have a tax reform idea.

Representative VAN HOLLEN. Yes.

Dr. RIVLIN. You move some of it forward.

Representative VAN HOLLEN. That is right. And, again, on net, your tax reform ideas would generate $2.2 trillion on the current policy baseline, correct?

Dr. RIVLIN. Right.

Representative VAN HOLLEN. Okay.

Let me talk a minute about jobs and the economy, because the Congressional Budget Office has said that about a little over one-third of our current deficit today is as a result of the fact that we have a very weak economy, we are not operating at full potential. So I think all of us agree that we need to get the economy moving again.

Dr. Rivlin, you pointed out that your plan with Senator Domenici had about $680 billion in payroll-tax relief. And I think you said the other day on one of the Sunday shows you would, "go bigger" than the President's job plan.

Do you believe that something like that is necessary at this time?

Dr. RIVLIN. Yes. I think we are in danger of slipping into stagnation, and we should do something about it.

Representative VAN HOLLEN. Mr. Bowles, would you agree that it would be a bad idea this coming year to have every working American see an increase in their payroll tax relative to last year?

Mr. BOWLES. Yeah, on the payroll tax that was in the President's proposal, I think it was about $240 billion out of a $447 billion?

Representative VAN HOLLEN. That is right.

Mr. BOWLES. And it is hard for me, as a fiscal conservative, to say this, but I could support a continuation of the payroll-tax deduction for, you know, another year for employees.

It is very hard for me to understand how an approximately $600 deduction for the employer on a temporary basis is going to be enough to get them to hire a full-time, permanent $30,000-a-year employee. So I don't think I would support the payroll-tax deduction for the employer. I could see supporting it for the employee if we could pay for it.

Representative VAN HOLLEN. Okay. Thank you.

Just——

Mr. DOMENICI. Could I say——

Representative VAN HOLLEN. Yes?

Mr. DOMENICI [continuing]. On our end, I am for what we told you we are for, but I wouldn't argue if you followed his suggestion. As I see it, it is still alive. And what he is talking about is certainly better than nothing.

Representative VAN HOLLEN. Got it. Thank you. Thank you, Senator Domenici.

On health care—and, Dr. Rivlin, you have testified many times in front of the Budget Committee and stated that you thought that the Affordable Care Act introduced a number of very important innovations. I agree with you that we need to do more in terms of modernizing the Medicare system to focus more on the value of care and the quality of care versus the quantity of care.

I do have a question with respect to your version of the premium support plan, the most recent one. And that is, if you are confident in the market forces driving down the prices and if your argument is that Medicare is driving those market forces, then why would you need a fail-safe mechanism? In other words, why would you need to say, if you don't achieve the goal we want in savings, you have to have GDP plus 1? And if it is not keeping track with the market, isn't that just a cost transfer to Medicare beneficiaries?

Dr. RIVLIN. Well, I am not absolutely certain how the markets will work. We have seen even in the limited market that is Medicare Advantage that in some places they work well and come in under the fee-for-service and in other places they don't. We think this is a much more robust plan than Medicare Advantage.

But the reason you want the fail-safe is so the Congress will absolutely know what they are going to spend going forward on Medicare. It is not going to grow faster than this. It is a defined contribution. And we think that is very useful.

And as for the cost-shifting, there might be some cost-shifting, but then you could arrange it so that it is not cost-shifting onto lower-income people—it is means-tested, as we were saying before—it is cost-shifting onto people who can better afford it.

Representative VAN HOLLEN. Right. Well, I think that, again, I mean, if we are confident that the market forces were going to work the way intended, then I don't think there would be a need for a backup. I do know that Members of Congress and folks who are on the Federal Employees Health Benefit plan, for example, they bid, different plans bid, and there is a defined-support mechanism that is set in law, 72 percent-28 percent. So I am not sure why we would be proposing something different for Medicare beneficiaries.

Let me just close, Mr. Chairman, by saying we asked, actually, CBO to take a look at some of these ideas, including one where we just had competition among the managed-care plans and another one where we threw in the wrinkle of premium support. It wasn't the second-lowest bidder. It was more along the lines of what some other plans did, which was just marketplaces. And just having competition among the managed-care plans they said came out a score of about $9 billion between 2014–2021. Adding in this other mechanism achieved about—it took you up to a total of about $25 billion.

So it is pretty clear, at least from these numbers—and we can take a look at them—that we are going to need to do other things, that this is not a panacea, at least according to CBO's numbers, for dealing with the Medicare challenge, that we need to look at a lot of these other innovative ideas that are out there, including some of the things that have been talked about today.

Thank you, Mr. Chairman.

Chairman HENSARLING. Thank you.

The gentleman yields back.

All time for Member questions has concluded.

However, I would note, prior to Senator Simpson's departure, he did mention, Mr. Bowles, that you had something you might want to present. Without objection, I would certainly yield you a couple of minutes if I understand you have something else you wish to present to this committee.

Mr. BOWLES. I can do it very quickly. I tried to think, if I were sitting in your shoes or I was the go-between as I was in the what became the Simpson-Bowles plan, if it was possible for you all to get to the $3.9 trillion deficit reduction, given where your positions are today, and I think it is, I think you can get this done, and I will just go through briefly the arithmetic. And, again, you have got to flesh out the policies, but if you look at where I understand the two sides now stand, and this is from just listening, which is what you have got to do if you are the guy in the middle, you know, the proposals for discretionary spending, and these are all above what the $900 billion and the 400 that was in the continuing resolution, so this is in addition to the $1.3 trillion worth of spending cuts that have already been done, but you all are between $250 and $400 billion of additional cuts on discretionary, so I assumed that we could reach a compromise of an additional $300 billion on discretionary spending cuts.

On health care you are somewhere between $500 and $750 billion of additional health care cuts. I assumed that we could get to $600, and I got there by increases in the eligibility age for Medicare that I discussed with Senator Kerry when he was talking to me. That is about $100 billion. That would take you from the 500 where the Democrats are to $600 billion, and it happens to come not on the provider side, which I think would kind of balance that out.

On other mandatory cuts, you are somewhere between 250 and 400, so I settled on 300 there, and we had enough cuts in our plan to get you to 300 on the other mandatory. Interest will obviously just fall out at approximately 400 billion, the savings there. You agreed actually on CPI in your two plans of approximately $200 billion. The total of that is $1.8 billion. That left me a little short.

That gets me to revenue. And on revenue I took the number that the Speaker of the House, I had read had actually agreed to, and I was able to generate $800 billion through revenue from the Speaker's recommendation, and if you did that without dynamic scoring, but you did it, and, you know, on dynamic scoring I am kind of on the Reagan plan, trust and verify, which we talked about earlier. If it actually comes, great, you will use it to reduce rates or you will use it to reduce the deficit. But if you add the $800 billion there and you do that slightly on a more, make it so the code is slightly more progressive after you have done it than before, then I think you have really got something that you might be able to work with the Democrats on.

That would give you an additional total of $2.6 trillion added to the 1.3 you have already done. That is $3.9 trillion in deficit reduction, and I think that would create a lot of excitement with people in the country, and I think it would go a long ways toward building up confidence that we really could stand up to our problems.

Chairman HENSARLING. Thank you, Mr. Bowles. You certainly created some excitement with the press, I think. I would say, don't necessarily believe everything you read and hear about the proceedings of this committee.

I do want to thank every single member of the panel on behalf of the Joint Select Committee for Deficit Reduction, not just for your presence here today away from your businesses and your families, but, frankly, more important, the entirety of what you have lent to the body of work to try to really address a very real crisis that we face. I do thank you for that. Your testimony was certainly sobering and helpful, and not the least of which was timely.

I do want to remind all members that they have 3 business days to submit questions for the record, and I would ask our witnesses to respond promptly to the questions. Members should submit their questions by the close of business on Thursday, November 3rd.

With no other business before the committee, without objection, the joint committee stands adjourned.

[Whereupon, at 4:35 p.m., the joint committee was adjourned.]

APPENDIX

Additional Material Submitted for the Record

Testimony Before the Joint Select Committee on Deficit Reduction
November 1, 2011

Erskine Bowles and Sen. Alan Simpson
Co-Chairman of the National Commission on Fiscal Responsibility and Reform

Chairman Hensarling, Chairwoman Murray, members of the Committee, thank you for inviting us here today to discuss the recommendations of the National Commission on Fiscal Responsibility and Reform, and thank you for your continued hard work to improve our nation's fiscal situation. We know, a little too well, how difficult your job is.

As Co-Chairmen of the National Commission on Fiscal Responsibility and Reform, we spent more than half of 2010 studying the cold, hard facts concerning our nation's fiscal situation, which you are undoubtedly over familiar with at this point. When asked why we did it, we originally said that it was for our 15 grandkids. However, the deeper we got into the numbers, the more dire we understood our Country's financial situation to be. And we quickly realized we were not doing this for our kids, much less our grandkids, we were doing it for all of us.

We realized that the fiscal problems facing our Country were enormous, the solutions would all be painful, and there simply was no easy way out. We are all going to have to share in the sacrifice that is needed to put our fiscal house in order. Everything must be on the table, and Washington must lead. And right now, this Committee has a unique opportunity to do just that.

While we know better than most how challenging the task in front of you is, we can tell you that the American public is looking for leaders who will make tough choices, and that if the Committee puts forward a credible plan the public will support you. If you are bold, you can put forward a smart, well-formulated deficit reduction plan that not only reduces our deficit, but also maintains our economic health and restores public confidence in America's ability to govern wisely and prudently.

Unfortunately, time is not on our side and we truly can no longer afford to wait. Washington needs to enact a fiscal plan NOW -- not next year, not after the next election, but now. Continuing to kick the can down the road by enacting short-term, temporary fixes is bad policy, and doesn't change the fact that we will have to make these difficult choices no matter what – be it now or in the future, when our debt holders force us to take action. The longer we put these choices off, the more difficult and potentially harmful they become.

There are no other ways to say it. We simply cannot delay these difficult choices anymore. Our great Nation's fiscal house is now made out of straw and any significant blow – an oil shock, a collapse in Europe – can blow our house down. This is certainly no way for such a great country to exist.

We all know how big and real the problem is – we heard it from countless economists and budget experts, and we know that you have too. We aren't here to repeat those numbers for the millionth time. We're here to share what we learned as co-chairmen of the Fiscal Commission, in the hopes that it helps all of you to reach a similar deal.

Our plan was developed following six main principles:

FISCAL COMMISSION'S GUIDING PRINCIPLES

1. First, we didn't want to do anything that would disrupt what is still a fragile economic recovery. So we made smaller cuts in 2011 and 2012 and big cuts in 2013, cuts of such magnitude that we would get back to pre-crisis (2008) levels of spending in real terms by 2013. At the same time, we heeded the advice of economists who told us that putting into place a credible plan to reduce future deficits would have a positive effect on the economy by increasing market confidence and providing a more certain fiscal outlook.

2. Next, we wanted to protect the truly disadvantaged. In our budget you won't see any cuts in SSI or Food Stamps or Workers Compensation. And we proposed changes to strengthen the safety net features of Social Security that cost money and made achieving our fiscal goals harder.

3. We also wanted to ensure that we did nothing to jeopardize the safety and security of the country -- we could not put forward a plan that fixes the budget but leaves our nation vulnerable. We agreed with Admiral Mullen, former Chairman of the Joint Chiefs of Staff, when he said that our Nation's greatest National Security problem is this debt. Thus, while it's clear that defense spending must be on the table, we made sure that the safety of the United States was our top priority.

4. We have to protect our nation's most important investments, like education, infrastructure, and high value-added research. We need to make these investments in a fiscally responsible manner by taking our limited resources and using them more wisely. Limited resources force you to make choices, and we must make the choices now and work carefully to prioritize our spending.

5. We must reform the broken tax code in order to promote growth as well as reduce the deficit. We have the most anti-competitive, inefficient, ineffective tax code man could dream up. The tax code must be reformed to broaden the base, lower rates for individuals and employers and reduce the deficit. We also need to reform the corporate tax system, to create jobs and to make the United States the best place in the world to start and grow a business.

6. We have to cut spending wherever we find it -- in the defense budget, the non-defense discretionary budget, the tax code, and in the entitlement programs. It's simply a fact that our politicians in both parties over a long, long period of time have made promises that they can't keep.

PLAN SUMMARY/MAJOR ELEMENTS

Using those six principles, we crafted a plan that received support from a bipartisan supermajority: five Democrats, five Republicans and one Independent. We cut $4 trillion over ten years, stabilizing debt as a percentage of GDP and putting it on a downward trajectory.

DISCRETIONARY SPENDING CUTS: Any serious attempt to reduce the deficit will require deliberate, planned reductions in both domestic and defense spending. The government will not be able to protect those in need or invest to achieve our nation's long-term potential growth if Washington squanders taxpayer dollars on duplicative or marginal programs with no measurable results. Our plan imposes tough discretionary spending caps to force budget discipline and recommend significant cuts in both security and non-security spending by cutting low-priority programs and streamlining government operations.

The Commission proposal set limits for discretionary spending that would freeze discretionary spending for 2012, a 5 percent cut in 2013, followed by growth at about half inflation through 2020. This would bring discretionary spending back to pre-crisis (2008) levels in real terms by 2013. We applied the same approach to security and non-security. These caps required spending to be cut by nearly $1.7 trillion below the President's fiscal year 2010 budget request. Much of these savings have been achieved as a result of the spending cuts enacted in the fiscal year 2011 appropriations bills as well as the Budget Control Act. However, our caps would require more than $400 billion in savings beyond the Budget Control Act, primarily by holding the growth of discretionary spending to half the rate of inflation after 2015 in order to keep pressure on agencies to increase efficiencies and squeeze out waste and low priority spending.

We also required the President to propose limits on war spending consistent with the projected needs under current policies, with the spending levels in the CBO troop drawdown scenario as the starting point. We did not claim savings from putting limits on war spending, but rather sought to ensure that the savings from the drawdown in troops that was already planned would go to deficit reduction and not be used for new spending or to get around the limits on regular defense spending. We also put in place a strict definition of war spending to prevent the war spending account from being used as a slush fund for unrelated defense spending.

The Commission also recommended several reforms of discretionary spending to improve the transparency and accountability of spending. We proposed budgeting for disaster spending, placing greater restrictions on the use of emergency funds and establishing strict criteria for war supplementals. Finally we proposed making spending from transportation trust funds mandatory spending, limited to actual dedicated revenues collected by the trust fund in the prior year, and proposed a 15 cent increase in the gas tax to make the trust funds whole or a reduction in spending to match the actual revenues coming in to the trust fund.

COMPREHENSIVE TAX REFORM: Rather than tinker around the edges of the existing tax code, the Commission proposed fundamental and comprehensive tax reform that would sharply reduce rates, broaden the base, simplify the tax code, and reduce the deficit by reducing the many "tax expenditures" – another name for spending through the tax code. Our proposal also reforms corporate taxes to make America the best place to start a business and create jobs.

The Commission proposed a "zero based budgeting" approach to tax reform: starting with a clean tax code that didn't have any tax expenditures and had much lower rates and then deciding which tax expenditures should be added back and which rates should be increase to pay for them. We estimated that if all tax expenditures were eliminated we could eliminate the Alternative Minimum Tax, bring individual income tax rates down to 8 percent, 14 percent, and 23 percent and reduce the corporate rate to 26 percent while achieving $80 billion in deficit reduction in 2015 and $180 billion in 2020

We realized that elimination of some tax expenditures could cause unintended problems and that Congress would want to preserve some of the tax expenditures. However, we concluded that starting with a completely clean tax code and forcing advocates of various tax expenditures to justify why they should be added back and how the costs should be offset would result in a much simpler, efficient tax code than would be possible if we started with the status quo.

We developed an illustrative plan to show how some tax expenditures important to commission members could be restored in a modified form while still keeping rates low. This plan demonstrated that it is possible both to reduce rates dramatically and to achieve significant deficit reduction if tax expenditures are eliminated or scaled back and better targeted. The illustrative plan would set rates at 12 percent, 22 percent, and 28 percent, create a 12 percent credit for mortgage interest and charitable giving, consolidates and limits the size of retirement accounts and gradually phase out the health exclusion, among other changes. The illustrative plan would preserve the EITC and child credit in their current form or an equivalent alternative. The result of this illustrative plan is a tax reform package that is more progressive than current law and achieves the deficit reduction targets in the Commission plan while dramatically reducing marginal tax rates.

The Commission recommended corporate tax reforms which would eliminate all tax expenditures for business, establishing a single corporate rate at the same level as the top individual tax rate (between 23 and 29 percent) and provides for a competitive territorial system, thus making America a globally competitive place to start and grow a business and attracting billions of dollars back to the country.

HEALTH CARE COST CONTAINMENT: Our plan included specific policies to achieve nearly $500 billion in health care savings in the near term, with a portion of that used to offset the cost of repealing the CLASS Act; over the long term we put federal health care costs in a budget.

Our plan included specific policies to achieve at least $400 billion in net health care savings in the near term, with additional savings to offset the cost of repealing the CLASS Act, and over the long term put federal health care costs in a budget. The near term savings would come from health care providers and drug companies through adjustments in payment formulas and increased drug rebates for Medicaid and Medicare, from beneficiaries through more rational cost-sharing rules that discourage the overutilization of care, and more from lawyers through tort reform. We also achieved savings by eliminating state gaming of Medicaid, reforming federal employee health benefit program and reforms of TRICARE.

Our belief was that these savings, in addition to the savings from the Affordable Care Act, would reduce the costs of federal health care programs to GDP plus one percent. But we proposed backing that up with a review process to ensure that cost growth is reduced to GDP plus one percent and recommended that Congress consider more aggressive reforms, such as premium support, a robust public option and increasing the Medicare eligibility age.

MANDATORY SAVINGS: Our goal in this area was to reduce low priority or wasteful spending, including subsidies that are poorly targeted or create perverse incentives. We felt that income support programs for the most disadvantaged, such as unemployment compensation, food stamps, and Supplemental Security Income (SSI), should not be touched. These programs provide vital means of support for the disadvantaged, and the commission did not recommend any fundamental policy changes to these programs. The plan achieves savings from reducing agriculture subsidies, modernizing military and civil service retirement systems, putting the Pension Benefit Guarantee Corporation on a sustainable path and other reforms.

SOCIAL SECURITY REFORMS TO ENSURE LONG-TERM SOLVENCY: We did not propose reforms of Social Security to reduce the deficit; the Social Security plan would have very little impact on the budget in the near term and we did not count any of those effects in meeting our deficit reduction targets. Rather, we proposed reforms of Social Security to ensure that the program remains strong and financially viable for future generations and to meet our mandate of making recommendations to "meaningfully improv(ing) the long run fiscal outlook" – which is part of this committee's mandate as well. We wanted to make sure the system is sustainably solvent over the long term – to make sure it can continue to provide the foundation for a secure retirement not just for old guys like us, but for our kids and our grandkids. That's why we have focused on 75-year sustainable solvency for Social Security.

Saving Social Security will require shared sacrifice. Those at the top will have to contribute the most, both through higher payroll taxes and lower-than-scheduled growth in benefits. Middle income workers will also have to contribute, but can do so primarily by working a little longer, to the extent they are able. Those who are most vulnerable should actually receive additional protections, in order to make sure Social Security is fulfilling its fundamental mission to keep seniors out of poverty. Our plan would restore solvency through a combination of a gradual increase in the eligibility age for Social Security, with a hardship exemption to cover individuals with physically demanding jobs, progressive changes in the benefit formula that would reduce benefits for middle and upper income workers, a gradual increase in the amount of wages subject to payroll taxes and more accurate COLAs. It also provided greater poverty protections by implementing a higher new minimum benefit and providing a bump up for older beneficiaries who are more likely to end up in poverty as a result of exhausting private savings.

The plan developed by the Commission would achieve sustainable solvency – meaning we would continue to have balance in the 75th year – in a way that phases in changes quite gradually while providing greater poverty protections than current law and making the program more progressive.

<u>Process Changes</u>: The Commission proposal included recommendations that would achieve enough savings to more than restore primary balance and stabilize the debt under current projections. However, members of the Commission thought that it is important for Congress and the President to remain vigilant to ensure the budget remains on a course to primary balance and a stable debt to GDP ratio. We therefore recommended an enforcement mechanism to ensure the budget achieves primary balance by 2015 and the debt is stabilized thereafter by requiring the President and Congress to take action if the debt begins to grow as a percentage of GDP.

A Two-Stage Process to Go Big

This Committee has been given a mandate to find at least \$1.2 to \$1.5 trillion in deficit reduction. While this will not solve our fiscal problems or avoid a fiscal crisis (at best, \$1.2 trillion would merely delay it), it is supremely important that the committee succeed – for the sake of our economy and public confidence in their leaders.

A failure by this committee might result in another downgrade. The only thing worse than the committee failing to agree on savings would be if Congress followed that by voting to turn off the sequester. Thus, removing that option by successfully voting out a plan should be strived for. At best, a failure would shake public confidence. None of these options are acceptable. So the Committee should work to reach agreement on as many specific options for savings as possible that can be ready to go by the November 23rd deadline.

While \$1.2 trillion in deficit-reduction would be a small step forward, it's important that the American people understand and the Congress realizes that \$1.2 trillion in deficit reduction will not solve our long-term fiscal problems and that significantly more deficit reduction will need to be done to stabilize the debt and put it on a downward path as a percent of GDP. By now everyone must understand that \$4 trillion dollars of deficit reduction is not the maximum we need to reduce the deficit over the next ten years, it is not the ideal amount, it is the minimum amount we need to reduce the deficit to put our fiscal house in order and to stabilize our debt and get it on a downward path as a percent of GDP.

We understand that it may not be possible for the Committee to have the major entitlement or tax reforms that will be necessary to stabilize the debt drafted into legislative language and scored by CBO by the November 23rd reporting deadline. But this should not prevent the Committee from making recommendations in these areas as part of a comprehensive plan to stabilize the debt. The "Gang of Six" proposal provides a model to address the time concern: a two stage process that builds on the specific savings they can be enacted now, with a process for completing the job.

This Committee can agree on an overall framework that includes tax and entitlement reforms sufficient to stabilize the debt. The Committee's plan for deficit reduction could be implemented in a two stage process, with as many specific savings as possible enacted as part of the Committee recommendations. These savings would be accompanied an outline for the process for implementing the rest of the agreement.

This is similar to previous deficit reduction packages such as the 1997 Balanced Budget Agreement, in which negotiators reached agreement on broad parameters and some specific policies that were reflected in a budget resolution with additional policy details later resolved and legislative language drafted through the budget reconciliation process.

A two-stage approach would maximize the prospects for reaching agreement on at least $1.2 trillion in savings immediately and putting in place a process reduce the deficit by at least $4 trillion over the next ten years and thereby stabilize the debt as a percentage of GDP. Finally, it gives the committees of jurisdiction, who have expertise on relevant policy areas, the time to work through the policy issues involved in a thoughtful manner and creates buy-in for the final legislative process by giving more members an opportunity for input through the committee process.

LESSONS FROM THE COMMISSION

We learned a lot from our time as co-chairs of the Fiscal Commission that may be helpful to you as you get down to the hard work of trying to reach agreement on a responsible plan.

First, we learned that any fiscally responsible plan must be bold and comprehensive. It should restrain spending across the federal budget, reform the tax code, bring down health care costs, and make Social Security solvent and strong for the next 75 years and beyond.

We understand that Congress rarely does anything big or bold all at once and that many Washington insiders are telling you that trying to go beyond your mandate to achieve the amount of savings necessary to stabilize the debt will make an already difficult challenge impossible. But in this case, a bold and comprehensive approach could actually help you reach your goals. Our experience on the fiscal commission proves it – the more comprehensive we made our plan, the easier our job became.

Many of these same Washington insiders who are advising that trying for a "go big" solution will lead to failure were shocked that we so aggressively exceeded our mandate when we presented our co-chairmen's proposal to the rest of the fiscal commission in November and were sure that the proposal would need to be scaled back to get a majority vote. It turned out that the opposite was true.

The tougher we made our proposal, the more people came aboard. Commission members were willing to take on their own sacred cows and fight special interests — but if and only if they saw others doing the same and if what they were voting for really did solve the country's problems. This spirit of shared sacrifice gained us broad bipartisan support, spanning from Democratic Sen. Dick Durbin to Republican Sen. Tom Coburn. We would not have garnered that type of support had we not taken on defense, domestic programs, the solvency of Social Security, health care, and spending in the tax code all at once. a comprehensive approach is necessary not only to match the magnitude of the problem, but to allow for the tradeoffs and balance necessary to reach a bipartisan agreement.

Second, putting together a responsible fiscal plan is not simply a matter of arithmetic. The strength of a fiscal plan depends not only on how much savings are achieved but how those savings are achieved. We face a structural problem that requires structural solutions that puts the budget on a solid long term path. You have to be smart in how you achieve savings. It is important to set priorities, such as reducing lower-priority spending while preserving funding for key investments necessary to compete in a knowledge-based global economy. And you should not make cuts that would harm the disadvantaged.

Third, Washington must lead the way. A realistic plan will require shared sacrifice by all but the most vulnerable in society. In order to ask for such sacrifices, we need to create a more efficient and cost-effective government, and root out waste wherever we find it.

Fourth, revenues need to be part of the solution, but as part of fundamental tax reform that moves beyond the zero sum argument about the Bush tax cuts that both parties have been fighting for and against over the last decade. The answer instead should focus on reforming revenues through a more efficient tax code that promotes economic growth. Today, we spend over $1.1 trillion a year on "tax expenditures" – credits, deductions, loopholes and exclusions which are really just spending by any other name. If we reform or eliminate these tax breaks, we can dramatically reduce personal and corporate tax rates, improve economic growth, and at the same time reduce the deficit. By reforming them, we can reduce individual and corporate tax rates in a way that keeps the tax code progressive while promoting economic growth and reducing the deficit at the same time.

Fifth, a plan to reduce the deficit must therefore promote economic growth and not undermine the economic recovery. In order to avoid shocking the fragile economy, the Commission recommended waiting until 2012 to begin enacting programmatic spending cuts, and waiting until fiscal year 2013 before making large nominal cuts. In addition, revenue changes would not begin until calendar year 2013, after spending cuts are already well underway.

Finally, and perhaps most importantly, we found that it is possible to put forward a serious, responsible fiscal plan to bring the debt under control while protecting the priorities and principles of both parties. We can raise revenues in a way that does not increase tax rates and promotes economic growth by removing economic distortions from tax expenditures and reducing marginal tax rates while improving progressivity in the tax code — because these tax expenditures disproportionately benefit upper-income taxpayers. Our work also showed us that it's possible to reform entitlement programs in a way that preserves and even strengthens the safety net for the most vulnerable while achieving significant savings.

Conclusion

In conclusion, the most important thing we learned is that neither party can fix this problem on its own, and both parties have a responsibility to do their part. We are all going to have to share in the sacrifice that is needed to put our fiscal house in order. Americans are counting on us to put politics aside, pull together not pull apart, and agree on a plan to live within our means and make America strong for the long haul.

The political system, by its very nature, moves slowly and sloppily. But we don't have a lot of time to act if we are to avert fiscal calamity.

Winston Churchill once said that "Americans almost always get it right, but only after they have tried everything else." All we know is that we better get it right soon or we're going to spend ourselves into the poor house before you know it.

The two of us are optimistic by nature and are hopeful that you will act decisively and as one. We believe that there is a real chance this super committee will put politics aside and pull together not pull apart. If you do, we're confident the future of this country will be very bright and we can withstand any blow that comes our way. And if we don't, we think America could become a second rate power in our lifetime, and the opportunities our children will have will for the first time in American history, be less than those experienced by their parents. The national interest, not special interests, must prevail.

Thank you again for inviting us to appear today. We look forward to your questions.

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TESTIMONY BY SEN. PETE V. DOMENICI AND DR. ALICE RIVLIN

CO-CHAIRS, BIPARTISAN POLICY CENTER DEBT REDUCTION TASK FORCE

TO

THE JOINT SELECT COMMITTEE ON DEFICIT REDUCTION, U.S. CONGRESS

NOVEMBER 1, 2011

BIPARTISAN POLICY CENTER

Senator Murray, Representative Hensarling and Members of the Joint Select Committee on Deficit Reduction , thank you for inviting us to testify on the enormous fiscal and economic challenges confronting our nation.

The testimony we have submitted summarizes more than one and a half years of deliberation by nineteen former senior policy makers ranging from former Democratic mayors of large cities to former governors, to former members of presidential cabinets. The Task Force represented a very diverse cross-section of the nation's economic and political interests.

The United States faces two huge challenges: (1) accelerating growth and job creation and (2) reducing future deficits to stabilize the debt so that it is no longer growing faster than the economy. These objectives reinforce each other. Faster growth will reduce deficits, and stabilizing the debt will cut future interest rates, reduce uncertainty and enhance growth. This Committee, with its extraordinary powers, has both the opportunity and the obligation to address both challenges.

The Bipartisan Policy Center's Debt Reduction Task Force urges you put ideology aside, cooperate across partisan lines, and craft a Long term budget plan that will put the country on a path to sustainable prosperity and responsible budgeting. To achieve success, the Committee will have go well beyond the minimum charge of identifying at least $1.2-$1.5 trillion in savings over the next ten years, because even savings of this magnitude would still leave the debt rising faster than economic growth. We believe you should craft a grand bargain involving structural entitlement and tax reform that would save at least $4 trillion over ten years. In order to do so, the Committee should take full advantage of the authority given to it by the Budget Control Act (BCA) in Section 404, and write instructions to compel authorizing committees to produce fundamental tax and entitlement reform and provide for "fast-track" consideration of those reforms.

We believe that a grand bargain would have enormous economic benefits and would also reassure citizens and markets that our political process is functioning in the public interest, not stuck in partisan gridlock or overwhelmed by special interests. Failure to reach agreement (or even settling for the minimal $1.2 trillion savings) would increase the chances of continuing weakness in the economy, high joblessness, and deep distrust of the ability of elected leaders to govern.

The BPC recommends a three-step process in order to spur our economy, achieve savings and stabilize our debt:

- **Step 1** was passage of the BCA, which provided $900 billion in discretionary savings, similar to the amount recommended by the BPC's Task Force.

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- **Step 2** – in progress – calls on the Committee to **identify a down-payment of $1.2-$1.5 trillion in net deficit reduction over ten years, which should be accompanied by a full payroll tax holiday to spur the economy**. The deficit reduction should utilize the many bipartisan plans that have been released, combining spending cuts from all parts of the budget with revenues. These savings also must be *real* – no budgetary gimmicks. Many of these policies will not be overly popular, but a comprehensive plan – one that addresses every aspect of the budget – is the most politically palatable approach.

- **Step 3** requires the Committee to take full advantage of Section 404 of the BCA and **instruct the relevant authorizing committees to legislate further reform**. The two primary areas of focus should be fundamental, pro-growth *tax reform that raises revenue*, and *structural Medicare reform* to ensure the future sustainability and efficiency of the program, as explained in the Domenici-Rivlin Protect Medicare Act.

Should the Committee fail to reach agreement on major reforms that will encourage growth and stabilize our fiscal situation, you will have missed an historic opportunity to set the country on the right track, and the consequences both to the economy and to public confidence could be dire. A sequester would produce mindless, possibly harmful cuts in spending, and even avoiding the sequester by finding $1.2 trillion would only kick the biggest part of the rising debt problem down the road. We urge you to seize the opportunity to get the job done.

The central elements of any grand bargain to stabilize our debt are clear:

1) Policies to promote growth and create jobs now;
2) Savings from discretionary accounts (which have already been enacted in the Budget Control Act);
3) Fundamental health care reform, especially Medicare; and
4) Fundamental tax reform that raises revenue.

The Bipartisan Policy Center's Debt Reduction Task Force, which we co-chaired, only was able to achieve consensus by addressing all four.

Payroll Tax Holiday

To jumpstart the struggling economy, we recommend enacting a full Social Security payroll tax holiday for both employers and employees for one full year. This immediately will increase consumer spending and business hiring, thereby delivering economic growth and creating jobs. The tax cut will provide financial relief for roughly 160 million American workers, many of whom are having difficulty making ends meet in the aftermath of the worst recession in nearly

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eighty years. A significant portion of the additional take-home pay will be spent quickly by consumers. Some of the money will undoubtedly go towards paying down debt, but household deleveraging is a necessary precondition for a return to low unemployment and sustained growth. A payroll tax holiday will help people get out of debt faster by adding roughly $3,000 to the average worker's paycheck.

Fundamental Health Care Reform

The fundamental problem to be addressed by this Committee is that federal spending is projected to rise faster than revenues for the foreseeable future leaving a widening gap to be financed by borrowing. The primary drivers of increased spending are the health care programs, including Medicare, Medicaid, and the subsidies to be provided by the Affordable Care Act (ACA). Huge projected increases in the number of older people, combined with persistent increases in health care spending per person account for this upward pressure on spending. Hence, reducing the rate of growth of these programs is essential to any long run debt stabilization plan. (See Chart)

Spending on mandatory healthcare programs is projected to increase from 23 percent of non-interest federal spending in 2011 to 34 percent by 2021.

Rising federal spending on health care is, of course, a part of the more general trend of increasing spending for health care in the economy as a whole. Over time, national health spending has grown about 2 percentage points per year faster than GDP and health care spending nationally is nearly 17 percent of GDP and rising. The objective of reforming federal health programs should not be to shift federal costs onto the private sector, but to use the federal programs to lead the way toward more effective and less wasteful delivery of health care, no matter how that care is paid for.

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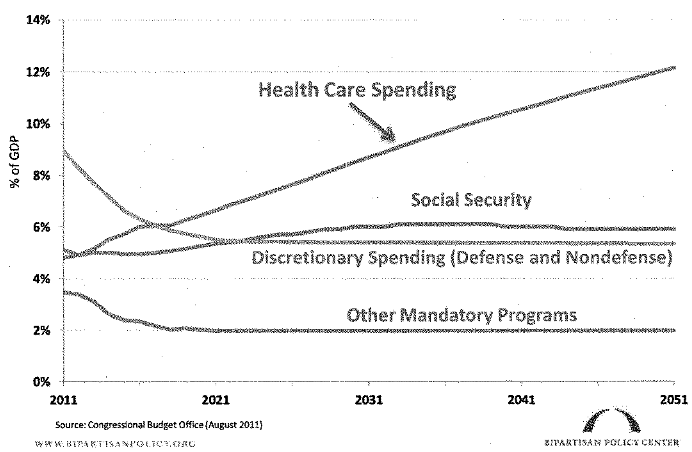
HEALTH CARE COSTS ARE THE PRIMARY DRIVER OF THE DEBT



The Task Force plan includes both demand- and supply-side approaches to slowing the growth in overall health spending and federal spending specifically. Some aspects target the health system in general, while others focus specifically on Medicare and Medicaid.

The major demand-side strategy is to cap and then phase out the tax exclusion of employer-sponsored health insurance (ESI) benefits. This policy will result in more cost-conscious choices by purchasers of health insurance.

Also on the demand side is a proposal to modernize patient cost sharing in the Medicare program. The modernized benefit structure will include a combined annual deductible for Parts A and B, and will provide catastrophic coverage – a protection that is sorely lacking today – thereby more closely matching recent trends in private health care plans.

The key supply-side strategy is to reform provider payment incentives. Moving payment away from fee-for-service and toward broader payment units will incentivize providers to seek more efficient delivery systems. Health reform – i.e., the ACA – took some very important steps toward reforming provider payments in Medicare. The Task Force proposes to build on this by bundling payments for post-acute care into the payment for inpatient care. Many other options for supply-side reform have received bipartisan support – this committee would be wise to select from some of those, as well.

For Medicaid, in the short term, the Task Force proposes to remove barriers to greater use of managed care for those dually eligible for Medicare and Medicaid. For the long term, significant changes to the program are needed – both narrowly-targeted and fundamental reform proposals should be given serious consideration.

Although each of these proposals will have beneficial effects for the national healthcare system help control federal costs, much of the long-run savings in the Task Force plan will come from transitioning Medicare from fee-for-service to a defined support option. This new system will marshal both demand- and supply-side leverage to transform the national healthcare infrastructure into a more efficient and effective vehicle. As such, this is the proposal that we primarily will focus on today:

Domenici-Rivlin Protect Medicare Act

Simply put, there can be no lasting solution to the U.S. debt crisis without structural changes in the Medicare program to slow its cost growth. This can be done through our proposal to transition Medicare to a "defined support" plan. Such a system will provide major incentives to increase the efficiency and effectiveness of health care delivery to seniors – without abolishing current Medicare, or forcing any beneficiary to move to a different system – and cap total Medicare spending while protecting low-income seniors.

The Domenici-Rivlin defined support proposal will preserve Medicare for future generations. It will allow beneficiaries who wish to stay in traditional Medicare to do so, but also control program costs by providing them the option of choosing among competing private plans that could save them money. It will restrain the growth in total Medicare spending, while protecting low-income beneficiaries from any increases in their cost. In short, the Domenici-Rivlin plan both will preserve Medicare as a choice and also save money by flattening the now-steeply-rising Medicare cost curve.

The Domenici-Rivlin proposal restructures Medicare to achieve fiscal soundness in three ways:

1) A new federally-run Medicare Exchange will provide beneficiaries with a truly competitive marketplace in which they can choose among private healthcare plans and traditional fee-for-service Medicare (FFS). The private plans will be required to cover at least the same services as FFS Medicare, and their government subsidy will be adjusted up (or down) if they attract patients whose illnesses are more (or less) expensive than

average. The Exchange will provide understandable information about the costs and health outcomes of plans so that beneficiaries can choose plans that are best for them, and will allow beneficiaries, if they are not satisfied, to change plans in an annual open season. This competition will incentivize healthcare plans to innovate in every facet of their operations and benefit designs to keep premiums down and quality of care up.

2) By using competitive bidding, this system will tie the federal contribution to the cost of the 2^{nd}-cheapest approved plan or FFS Medicare in each area, whichever is cheaper. Thus, the government will no longer have to pay extra to private healthcare plans in areas where the public FFS plan provides cheaper coverage, nor will they have to overpay to provide FFS Medicare in areas where approved private plans offer the same care at lower cost.

3) These two cost-control features should flatten the cost curve. However, an additional element will ensure substantial savings. The growth in per-beneficiary federal support will be limited to one percentage point faster than the growth of the economy – "GDP+1%" – compared to the current projection of growth that is 1.7 percentage points faster. If costs rise faster than the established limit, Medicare beneficiaries will have to pay higher premiums. However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. This subsidy will phase out at higher income levels.

How the Exchanges Work

In each regional market – be it a metropolitan area, or a large rural area where population density is low – all of the private healthcare plans and traditional FFS Medicare will submit bids (subject to strict quality and coverage standards) to provide the standard Medicare benefit package for Parts A and B to an average-risk beneficiary. The FFS "bid" will be based on average FFS costs for the same type of standardized beneficiary in the bidding area. The amount that the government contributes to premiums in that area will then be based on the 2^{nd}-lowest private bid or FFS Medicare's bid, whichever is lower. This will be referred to as the "benchmark" bid.

Beneficiaries who choose to enroll in a plan that is more expensive than the benchmark – even if that plan is FFS Medicare – will be required to pay the incremental additional cost. A beneficiary who enrolls in the plan with the lowest bid will be rebated the full difference in cost from the benchmark

The Exchange will be federally run, presumably by the Centers for Medicare and Medicaid Services (CMS), require guaranteed issue (under which insurers may not decline any applicant), and enforce guidelines for the structure of the benefit package. CMS also will utilize risk adjustment by distributing the government subsidy among insurers according to the health status of those whom they enroll.

Why is this proposal an improvement over the current Medicare system?

Medicare Advantage already offers private plans to Medicare beneficiaries. However, if a private healthcare plan currently has lower costs than FFS Medicare in its area, it cannot offer a rebate to enrollees as an incentive to sign up. Instead, it must increase benefits – which in and of itself increases Medicare spending. Therefore, beneficiaries in areas with high FFS Medicare costs who enroll in private plans receive a host of free supplementary benefits, financed by the government. There is no policy justification for selectively offering free, government-financed supplementary benefits to beneficiaries in one geographic region but not another.

Instead, the new Medicare Exchange will provide strong incentives for plans to manage care-delivery efficiently and to offer the public evidence that their plans achieve quality outcomes at comparatively low cost – because low-bidding plans would be rewarded with increased enrollment.

The Domenici-Rivlin proposal also guarantees that the federal support per beneficiary will *not* grow faster than GDP+1%, thereby assuring the federal government of budgetary savings. The cap on the growth rate also should increase the pressure on plans to develop more efficient methods of care delivery, and might increase political support – by Medicare beneficiaries, their children, and those approaching Medicare eligibility – for federal policies that promote cost containment in health care. The Affordable Care Act already established a cap on the growth of Medicare; moving to a defined support model creates the incentives to make that cap stick.

In the event that Medicare spending per beneficiary rises at a faster rate, enrollees will have to pay higher premiums to cover the difference.[1] However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. The new system also could be structured to provide a higher subsidy to those with lower incomes and a lower subsidy to those with higher incomes.

[1] To promote stability, the proposal calls for employing a five-year historical trend of per-capita GDP rather than measuring the change over a single year.

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Fundamental, Pro-growth Tax Reform

Unfortunately, even if we are able to significantly bend health care's cost curve through the Protect Medicare Act and rein in other spending, the aging of the population and retirement of the baby boom generation is not something that we can control. In order to stabilize the debt, therefore, we must raise more revenue. But, this can be achieved through fundamental tax reform that broadens the base, lowers tax rates, and promotes economic growth.

The Bipartisan Policy Center's Tax Reform Plan represents a radical simplification of the current tax code and raises $2.2 trillion more in revenue than current policy[2] (or, $1.7 trillion less than current law). In fact, to best explain it, forget what you know about the complexities of the current tax system, and start fresh. Outlined below are the core elements of the plan:

- A **two-bracket income tax with rates of 15% and 28%**. Because there is no standard deduction or personal exemptions, the 15% rate applies to your 1st dollar of income.[3]

- The **corporate tax rate will be set at 28%**, instead of the current 35% level.

- Capital gains and dividends will be taxed **as ordinary income (with a top rate of 28%)**, excluding the first $1,000 of realized net capital gains (or losses).[4]

- To replace the overly-complex Earned Income Tax Credit (EITC) and to help offset the elimination of personal exemptions, the standard deduction and the child credit, the BPC Plan will establish:
  - A flat **refundable per child tax credit of $1,600** (higher than current law); and
  - A **refundable earnings credit** similar in structure to the recent Making Work Pay credit, but substantially higher.

- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing consumption and charitable giving of upper-income taxpayers, the BPC Plan will:
  - Provide a **flat 15% refundable tax credit for charitable contributions** and for up to $25,000 per year, not indexed, **mortgage interest on a primary residence**.
  - Eliminate the deduction for state and local taxes.

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[2] Current policy baseline assumes that all 2001/2003/2010 income and estate tax cuts are extended and that the AMT is indexed to inflation.
[3] The 27% rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[4] $500 for singles and heads of household

- Provide a flat, **15% refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement saving accounts** up to 20% of earnings or a maximum of $20,000.

- Include 100% of Social Security benefits in taxable income, but:
  - Create a non-refundable credit for Social Security beneficiaries equal to 15% of the current standard deduction; and
  - Create a non-refundable credit equal to 15% of an individual's Social Security benefits.

- Allow deduction of medical expenses in excess of 10% of AGI (as in current law).

- Allow deduction of miscellaneous itemized deductions in excess of 5% of AGI.

The BPC Plan achieves a massive simplification of the tax code by **aligning the top individual, capital gains and dividend tax rates, significantly reducing the corporate tax rate, and eliminating the AMT**. Additionally, **most individuals will no longer have to file an annual tax return**[5] beyond an initial declaration of status because the most commonly taken deductions have either been turned into refundable credits, determined solely based on the number of children and earnings, or can only be deducted above a substantial floor. Despite a low top rate of 28%, the new tax system created under the BPC Plan will be **more progressive than the current system** and **raise the requisite revenue to achieve a sound debt-reduction goal.**

How the Joint Select Committee on Deficit Reduction can reach the grand bargain

To put our country's budget back on a sustainable path, these three elements are essential. However, time is short. With the deadline to report recommendations only three weeks away, writing legislation to fundamentally reform Medicare or the tax code is unrealistic. **Still, this Committee can achieve these objectives.**

Section 404 of the Budget Control Act (BCA) provides this Committee the power to draft legislation that must be voted on by the House and the Senate and, if approved, presented to the president for his signature. Significantly, such legislation could:

- Order the committees with jurisdiction over entitlements and revenues to report legislative language by a specific date next year (for example, April 15, 2012), after the

[5] According to Tax Policy Center projections, only 50% of tax units would be required to file tax returns, as opposed to 88% under the current tax system.

expiration of the Joint Select Committee (JSC) itself, to change their programs to reduce projected federal deficits by an amount certain.

- In that order, the JSC could specify explicitly not only the deficit reduction targets to be met, but also the nature of the structural program changes to be made – and by so doing, enforce what would be a true and binding agreement between the two political parties that had been negotiated within the JSC.

- The legislation developed by the instructed committees would be reported back to the House and Senate Rules Committees (or the Budget Committees) and combined into one bill, which would be scored by the Congressional Budget Office.
- The JSC, further, could order that the legislation reported back by the instructed committees receive "fast-track" treatment in the House and Senate, which could be similar to the fast-track treatment afforded to some other types of legislation, and would be determined by the recommendations of the JSC itself.

- Lastly, the JSC could draft the legislative language so that failure to produce the substantive legislation would trigger a sequestration, either conforming to the instructions given to the committees and in the amount of the deficit reduction targets required by the JSC, or in some new manner that could be specified by the JSC.

In sum, Section 404 of the BCA gives the JSC the power to do much more than just find savings of $1.2 trillion to $1.5 trillion; it also has the power to establish and enforce a process that uses existing congressional committees to change entitlement and tax policies.

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APPENDICES

TESTIMONY BY SEN. PETE V. DOMENICI AND DR. ALICE RIVLIN

CO-CHAIRS, BIPARTISAN POLICY CENTER DEBT REDUCTION TASK FORCE

TO

THE JOINT SELECT COMMITTEE ON DEFICIT REDUCTION, U.S. CONGRESS

NOVEMBER 1, 2011

1. 3-step process, $1.2-1.5 trillion spreadsheet and JSC instructions for authorizing committees: How the super committee could stabilize the debt
2. Background document on savings of $1.2 trillion (Step 2): A $1.2 trillion down payment on deficit reduction
3. Section 404 one-pager: The super committee's "super" authority under the Budget Control Act
4. Domenici-Rivlin Medicare Act: Protecting and reforming Medicare
5. Tax reform summary: Creating a simple, pro-growth tax system
6. Payroll tax holiday brief: Economic growth and the payroll tax holiday

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THE ROAD TO THE GRAND BARGAIN

STEP I →

DONE

- Establish Joint Committee on Deficit Reduction
- Cap discretionary spending to save $917 billon

STEP II →

IN PROCESS

- $1.2-1.5 trillion in additional savings
- Mandatory spending restraint
- Eliminate some tax expenditures
- Grow the economy through the enactment of a full Social Security payroll tax holiday

STEP III

THE GOAL

- Issue instructions to committees
- Change programs within their jurisdiction to achieve fundamental tax and entitlement reform
- Report changes by a date certain
- Expedited legislative process

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How to "go big" within the Budget Control Act (BCA) Framework

- **STEP #1:** Approximately $900 billion in domestic and defense discretionary spending cuts over 10 years that were contained in the initial stage of the Budget Control Act.

- **STEP #2:** Approximately $1.65 trillion in deficit reduction policies over 10 years and a Social Security payroll tax holiday for CY2012 to be proposed by the Joint Select Committee (JSC)
  - The net $1.2 trillion in savings could consist roughly of:
    1. $100 billion in further discretionary cuts (half defense, half domestic)
    2. ≈ $350 billion in other mandatory cuts
       a. Switch to the chained CPI measure of inflation, civilian and military retirement reforms, cut back on farm subsidies, and increase some fees, among others
    3. ≈ $600 billion in health care savings
       a. Update Medicare's cost-sharing rules, introduce a surcharge for first-dollar Medigap coverage, malpractice reform, among others
    4. ≈ $450 billion in small tax expenditure cuts / revenue increases
       a. Switch to the chained CPI measure of inflation, eliminate the mortgage deduction for 2nd homes, remove many energy subsidies, among others
    5. ≈ $450 Social Security payroll tax holiday (employees: full holiday, employers: full holiday on first $3 million in payroll and all newly added payroll)
    6. ≈ $150 billion in interest savings

- **STEP #3:** Using the authority given to the Joint Select Committee in the Budget Control Act, the JSC should write legislation that compels fundamental reform in entitlement spending and in the tax code.
  - Section 404 of the BCA, in combination with other language in the Act, gives the JSC broad powers of an unprecedented nature. It can recommend further sequester action, for example, if it wishes. It can order committees of jurisdiction to make changes in entitlements and taxes and report those changes back in the form of legislative language by a date certain. What we propose, then, is that the work done by the JSC not only meet the mandate of the $1.2-1.5 trillion in savings in the next decade, but focus on how those changes in law would flow naturally to changes of a more fundamental and far-reaching nature in order to stabilize our national debt as a percentage of GDP.
  - In particular, we recommend that the JSC legislate:
    - A tax reform trigger to force tax reform by a date certain (e.g., April 15, 2012) that the CBO scores as providing net tax relief of no more than $1.7 trillion against current law through 2021;
    - A health care reform trigger to force additional health care savings to offset a permanent "doc fix" and passage of a premium support system for Medicare by a date certain;
    - And a trigger to force the passage of reforms to make Social Security sustainably solvent.

Net totals for the Budget Control Act (off of current policy baseline):
- Spending Cuts (including interest) ≈ $2.8 trillion
- Revenues ≈ $2.2 trillion
- Total Budget Savings ≈ $5 trillion

BPC'S RECOMMENDATIONS TO THE JOINT SELECT COMMITTEE
(One Way to Achieve a Net $1.2 Trillion in Savings for Step 2)

Page	*Indicates that there is more than one option for that policy listed in the background information	Approximate Savings (in billions of $)
	Medicare Savings	
1	Update Medicare's cost-sharing rules, provide catastrophic coverage + introduce a Part B premium surcharge for beneficiaries that purchase near first-dollar Medigap coverage	93
3	Reduce Medicare coverage of patients' bad debts	20
3	Accelerate home health savings in the ACA*	9
4	Introduce home health co-payments	40
5	Use Medicare's buying power to increase rebates from pharmaceutical companies	154
8	Bundle Medicare's payments / reform provider payments for post-acute care to reduce costs*	42
10	Better align graduate medical education payments w/ patient care costs*	60
12	Reduce or Eliminate Subsidies to Rural Hospitals in Medicare*	17
14	Increase Part B deductible for new beneficiaries	4
14	Eliminate provider carve-outs from IPAB	--
14	Make reforms to Medicare's Quality Improvement Organizations (QIOs)	3
15	One-year SGR fix	-12
	Total Medicare	**430**
	Medicaid Savings	
16	Eliminate state gaming of Medicaid tax gimmick	26
16	Apply a single blended matching rate to Medicaid, CHIP, and exchanges	21
17	Rebase Medicaid disproportionate share hospital (DSH) allotments in 2021	4
17	Limit Medicaid reimbursement of durable medical equipment (DME) based on Medicare rates	4
17	Shorten exclusivity period for brand name biologic drugs	4
18	Prohibit "pay for delay" agreements to increase the availability of generic drugs and biologics	3
19	Track high prescribers and utilizers of prescription drugs in Medicaid	4
19	Reduce Medicaid fraud	1
	Total Medicaid	**67**

Other Healthcare Savings

21	Limit medical malpractice torts	62
23	Increase TRICARE annual premiums and Rx copayments	22
24	Decrease investment in prevention and public health fund	4
25	Include Social Security benefits in income calculation to determine Exchange subsidy eligibility	15
	Total Other Health Care	**103**
	TOTAL HEALTHCARE	**600**

Other Mandatory Savings

26	Switch to the chained CPI measure of inflation	145
26	Reform civilian retirement	60
28	Reform military retirement	4
29	Reduce farm program spending	35
33	Reform the aviation passenger security fee to more accurately reflect the costs of aviation security	25
34	Adjust Pension Benefit Guarantee Corporation fees to better cover unfunded liabilities	16
36	Actuarially adjust flood insurance subsidies for risk*	12
38	Auction radio spectrum to expand wireless broadband and invest in a broadband network for public safety users	18
39	Index mandatory user fees to inflation	2
39	Restructure the power marketing administrations to charge market rates	2
40	Transfer the Tennessee Valley Authority's electric utility functions and associated assets and liabilities	4
42	Gradually lower the conforming loan limits for Fannie/Freddie	4
43	Increase guarantee fees charged by Fannie/Freddie	27
45	Provide Postal Service Financial Relief and Undertake Reform	19
46	Improve Collection of Pension Information from States and Localities	3
46	Get rid of unneeded Federal real property	4
47	Extend unemployment benefits through next year	-30
	Total Other Mandatory	**350**

Discretionary Spending Savings

	Nondefense Discretionary	50
	Defense Discretionary	50
	Budget appropriate amount in a disaster fund	-
	Convert to Security/Non-Security breakdown	-
	TOTAL DISCRETIONARY	**100**

Revenue/Tax Expenditure Savings

48	Switch to the chained CPI measure of inflation	72
49	Eliminate ethanol/biodiesal subsidies	19
52	Cut subsidies for employee parking expenses	38
52	Eliminate the mortgage deduction for 2nd homes/yachts	15
53	Tax carried interest as ordinary income	21
55	Cut subsidies for private-purpose state and local bonds	23
56	Eliminate Hollywood tax breaks	1
57	Timber subsidies	5
58	Remove many energy subsidies (solar, wind, oil and gas, coal)	61
58	Include All Income Earned Abroad by U.S. Citizens in Taxable Income	71
59	Exclusion of Certain Allowances for Federal Employees Abroad	18
60	Eliminate LIFO and LCM Inventory Accounting Methods	100
62	End certain economic development tax breaks	15
	1-year AMT offset	-9
	TOTAL REVENUES	**450**

Growth Initiative

	Mandate enactment of a full payroll tax holiday for employees and a full payroll tax holiday for employers (for up $3 million of payroll and all new hires) ***(BPC)***	**≈ -450**
	TOTAL INTEREST SAVINGS (estimate)	**150**
	TOTAL SAVINGS	**1,200**

BIPARTISAN POLICY CENTER

LEGISLATIVE INSTRUCTIONS FOR STEP 3

GENERAL[6]

CBO (with customary input from the Joint Committee on Taxation) is the umpire.[7]

CBO should provide economic analysis of the proposal over at least 20 years.[8]

CBO's static analysis should be the official score.[9]

For informational purposes only, CBO should provide a "dynamic analysis" of the ***entire*** legislative proposal, according to the procedures it inaugurated in *An Analysis of the President's Budgetary Proposals for Fiscal Year 2004*, March 2003.[10]

For informational purposes only, CBO should provide an alternative analysis of the proposal assuming that the Federal Reserve holds interest rates at their current level beyond the two years specified in its August 9 statement.[11]

Each bill from the Committees of jurisdiction will be held at the desk until all are completed.[12]

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[6] These "general" instructions might be added to each Committee's instructions, or put forward in some other way.
[7] There should be no estimate-shopping, else all discipline will be lost. CBO's methodologies and procedures have long standing, and have been accepted on all sides. Anyone who wants to refer arguments and analyses of others to CBO for their consideration is of course free to do so.
[8] In the long run, deficit reduction will increase economic growth by increasing national saving – and therefore business investment. If CBO is given only one consensus agreement, this procedural rule will have limited effect. If, however, as part of the process of developing a consensus plan, CBO is presented alternative proposals including some that provide less deficit reduction, this rule will illuminate the long-term consequences.
[9] This follows long-standing practice. It prohibits supply-side estimates of ***either*** tax cuts ***or*** investment spending. Note that a tax proposal that increase revenues beyond expectations will provide additional deficit reduction.
[10] CBO has used a range of alternative "dynamic" methods to estimate the effects of ***complete*** packages of proposals. The differences between CBO's static estimates and the alternative dynamic estimates have been (a) small and (b) roughly equally divided between deficit increases and decreases. Some non-governmental organizations have issued dynamic estimates, but their efforts have widely been regarded as far less rigorous.
[11] Some on both political extremes argue that deficit reduction harms economic growth, and so is undesirable for the foreseeable future. However, we need a firm commitment to deficit reduction within the foreseeable future. We square this circle if the Federal Reserve maintains low interest rates longer, stimulating economic growth while the budget transits from stimulus to deficit reduction. CBO's baseline budget forecast has the economy resuming normal growth and the Federal Reserve increasing interest rates as that occurs. If the deficit is reduced but the Federal Reserve follows an unchanged interest rate policy, then growth will suffer. An alternative interest rate forecast can assume the more accommodative policy that the Fed would be likely to follow if there were a firm commitment to deficit reduction.
[12] This simply dictates that, for example, concessions from one side on Medicare reform cannot become law without compensating concessions from the other side on taxes.

TAX POLICY

The Ways & Means / Finance bill shall not decrease revenues by more than $1.7 trillion over ten years compared to current law.

Taking into account estimable program changes in Social Security, Medicare and all other benefit programs, the bill shall use refundable tax credits to hold harmless, on average, the households in the lowest 20 percent of the income distribution.[13]

On the same basis and using static estimates, the bill shall decrease the after-tax income in each quintile ranked by gross income by a lesser percentage than for those quintiles with higher incomes.[14]

The maximum tax rate on individuals and corporations shall be no higher than 28 percent.[15]

MEDICARE POLICY

Beneficiaries (present and future) who wish to enroll in the current conventional Medicare program must have that option.[16]

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[13] The proposal of the Bipartisan Policy Center (http://www.bipartisanpolicy.org/sites/default/files/BPC%20FINAL%20REPORT%20FOR%20PRINTER%2002%2028%2011.pdf) demonstrates that this is possible.

[14] In other words, the tax changes should be consistently progressive by income quintile, using the change in after-tax income as the criterion. Specifying the criterion is important, and this one would be the choice of most experts. Although it might seem constructive to reference also smaller upper-income groups such as the top 10 percent, the top 5 percent, the top 1 percent, etc., distributional measures for those groups often have wiggles in them even for sound tax reform proposals. Excessively specific distributional criteria could possibly undermine what could be a fundamentally progressive deficit-reducing tax reform. Note also that the level of the top-bracket rate affects the potential to eliminate or reduce the highly regressive and complicating tax preferences for capital gains and dividends. In 1986, the Congress was willing to eliminate the capital gains exclusion in exchange for a top rate of 28 percent (which had been the capital gains rate since 1979). The higher the top bracket rate, the lower the probability of political acceptance of a lesser preference for capital gains; and the larger the capital gains preference, the less progressive the distributional result of the tax change. In the extreme, the result can be a vicious cycle or "Catch-22" in which progressivity requires a higher top-bracket rate, but the higher top-bracket rate brings on a bigger capital gains preference, and the bigger capital gains preference results in an unacceptable distributional result.

[15] This principle maximizes the chance of achieving a tax reform that is politically acceptable and fair, and that contributes to deficit reduction.

[16] The health care of current Medicare beneficiaries must not be interrupted. Future beneficiaries (such as rural residents who have limited choices among providers) who for whatever reason wish to participate in the current program must be allowed to do so. The option of using the current known system will be reassuring to many. But at the same time, the practice of health care in Medicare must change fundamentally to reduce current unsustainable cost growth. The best way to achieve efficiency in Medicare is to give beneficiaries the option of choosing among competing plans that must provide quality care at affordable cost to prosper. This is simply allowing competition to work as it does everywhere else in the economy. It is the Rivlin-Domenici approach. There is nothing else on the table that shows any prospect of success. It will be especially attractive to current workers who have coverage with which they are satisfied, and who might lose that coverage and their ongoing relationships with their providers if they are forced to switch to current Medicare when they turn 65. With a guarantee of access to conventional

Beneficiaries must have the option of enrolling in a wide range of competing private plans, in addition to the conventional Medicare program.

Medicare policy changes must fully offset a permanent fix to the sustainable growth rate formula within the 10-year window, and must provide increasing annual amounts of savings in later years.[17]

SOCIAL SECURITY POLICY

Separate from the deficit-reduction effort, legislation shall be prepared to achieve 75-year sustainable solvency of Social Security.[18]

All savings from the Social Security legislation shall be credited to the Social Security trust fund.[19]

Medicare, it should be acceptable to other informed beneficiaries. This instruction builds the foundation for all beneficiaries to have the coverage they want.

[17] This instruction requires the Committees of jurisdiction to find the necessary near-term program savings (as opposed to fundamental reform) to reach the deficit-reduction target. It also sets the general requirement that the savings from longer-term structural reforms must grow over time.

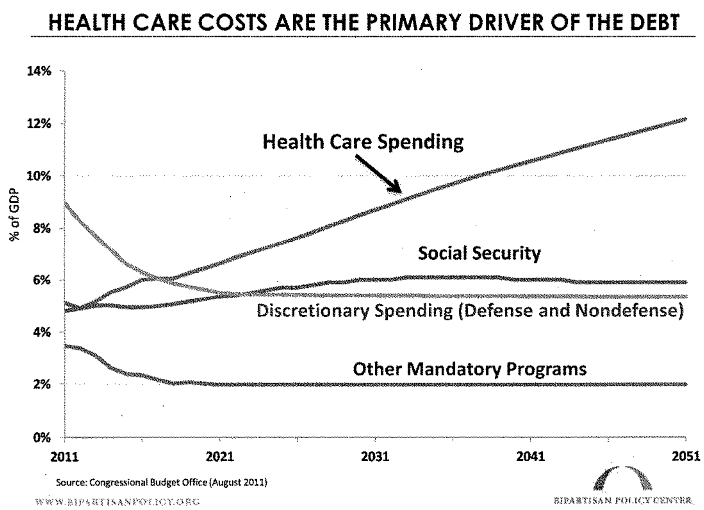
[18] Early repair of Social Security's finances will get the program out of the political line of fire, which all program advocates ought to support. Rhetorically, it must be clear that Social Security will be repaired for its own sake, not to balance the budget (though that of course is a subsidiary benefit). The sustainable-solvency standard means that the program is to be made sound not only over 75 years, but also in the 75th and subsequent years. That would avoid the uncertainty and political controversy that followed the 1983 legislation, which built up an oversized trust fund but allowed the program's finances to become unstable once the trust fund needed to be drawn down (i.e., now).

[19] This is one more rhetorical way to explain why the program itself is the primary winner if its finances are strengthened.

Domenici-Rivlin Protect Medicare Act

The principal driver of future federal deficits is the rapidly mounting cost of Medicare. The huge growth in the number of eligible seniors over the coming years is due to both increasing longevity and the retirement of the baby boomers. Then, that beneficiary growth is multiplied by continuing increases in the cost of health care. Without a significant change in this trend, the cost of Medicare will continue to rise faster than the economy can possibly grow. Even if revenues are raised and other spending is restrained (both of which the BPC supports), the exploding cost of Medicare is unsustainable.

Simply put, there can be no lasting solution to the U.S. debt crisis without structural changes in the Medicare program to slow its cost growth. This can be done through our proposal to transition Medicare to a "defined support" plan. Such a system will provide major incentives to increase the efficiency and effectiveness of health care delivery to seniors – without abolishing current Medicare, or forcing any beneficiary to move to a different system – and cap total Medicare spending while protecting low-income seniors.



The Domenici-Rivlin defined support proposal will preserve Medicare for future generations. It will allow beneficiaries who wish to stay in traditional Medicare to do so, but also control program costs by providing them the option of choosing among competing private plans that could save them money. It will restrain the growth in total Medicare spending, while protecting low-income beneficiaries from any increases in their cost. In short, the Domenici-Rivlin plan both will preserve Medicare as a choice and also save money by flattening the now-steeply-rising Medicare cost curve.

The Domenici-Rivlin proposal restructures Medicare to achieve fiscal soundness in three ways:

4) A new federally-run Medicare Exchange will provide beneficiaries with a truly competitive marketplace in which they can choose among private healthcare plans and traditional fee-for-service Medicare (FFS). The private plans will be required to cover at least the same services as FFS Medicare, and their government subsidy will be adjusted up (or down) if they attract patients whose illnesses are more (or less) expensive than average. The Exchange will provide understandable information about the costs and health outcomes of plans so that beneficiaries can choose plans that are best for them, and will allow beneficiaries, if they are not satisfied, to change plans in an annual open season. This competition will incentivize healthcare plans to innovate in every facet of their operations and benefit designs to keep premiums down and quality of care up.

5) By using competitive bidding, this system will tie the federal contribution to the cost of the 2nd-cheapest approved plan (subject to capacity constraints) or FFS Medicare in each area, whichever is cheaper. Thus, the government will no longer have to pay extra to private healthcare plans in areas where the public FFS plan provides cheaper coverage, nor will they have to overpay to provide FFS Medicare in areas where approved private plans offer the same care at lower cost.

6) These two cost-control features should flatten the cost curve. However, an additional element will ensure substantial savings. The growth in per-beneficiary federal support will be limited to one percentage point faster than the growth of the economy – "GDP+1%" – compared to the current projection of growth that is 1.7 percentage points faster. If costs rise faster than the established limit, Medicare beneficiaries will have to pay higher premiums. However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. This subsidy will phase out at higher income levels.

How the Exchanges Work

In each regional market – be it a metropolitan area, or a large rural area where population density is low – all of the private healthcare plans and traditional FFS Medicare will submit bids (subject to strict quality and coverage standards) to provide the standard Medicare benefit package for Parts A and B to an average-risk beneficiary. The FFS "bid" will be based on average FFS costs for the same type of standardized beneficiary in the bidding area. The amount that the government contributes to premiums in that area will then be based on the 2nd-lowest private bid or FFS Medicare's bid, whichever is lower. This will be referred to as the "benchmark" bid.

Beneficiaries who choose to enroll in a plan that is more expensive than the benchmark – even if that plan is FFS Medicare – will be required to pay the incremental additional cost. A beneficiary who enrolls in the plan with the lowest bid will be rebated the full difference in cost from the benchmark

The Exchange will be federally run, presumably by the Centers for Medicare and Medicaid Services (CMS), require guaranteed issue (under which insurers may not decline any applicant), and enforce guidelines for the structure of the benefit package. CMS also will utilize risk adjustment by distributing the government subsidy among insurers according to the health status of those whom they enroll.

Why is this proposal an improvement over the current Medicare system?

Medicare Advantage already offers private plans to Medicare beneficiaries. However, if a private healthcare plan currently has lower costs than FFS Medicare in its area, it cannot offer a rebate to enrollees as an incentive to sign up. Instead, it must increase benefits – which in and of itself increases Medicare spending. Therefore, beneficiaries in areas with high FFS Medicare costs who enroll in private plans receive a host of free supplementary benefits, financed by the government. There is no policy justification for selectively offering free, government-financed supplementary benefits to beneficiaries in one geographic region but not another.

Instead, the new Medicare Exchange will provide strong incentives for plans to manage care-delivery efficiently and to offer the public evidence that their plans achieve quality outcomes at comparatively low cost – because low-bidding plans would be rewarded with increased enrollment.

The Domenici-Rivlin proposal also guarantees that the federal support per beneficiary will *not* grow faster than GDP+1%, thereby assuring the federal government of budgetary savings. The cap on the growth rate also should increase the pressure on plans to develop more efficient methods of care delivery, and might increase political support – by Medicare beneficiaries, their children, and those approaching Medicare eligibility – for federal policies that promote cost containment in health care. The Affordable Care Act already established a cap on the growth of Medicare; moving to a defined support model creates the incentives to make that cap stick.

In the event that Medicare spending per beneficiary rises at a faster rate, enrollees will have to pay higher premiums to cover the difference.[20] However, individuals whose Part B premiums are paid by Medicaid programs will not be affected. Additionally, to smooth the transition to the defined-support system, current beneficiaries with low incomes will be guaranteed access to traditional Medicare with no additional premiums. The new system also could be structured to provide a higher subsidy to those with lower incomes and a lower subsidy to those with higher incomes.

Cumulative savings in billions of dollars, 2016 through:				
	2021	**2025**	**2030**	**2040**
Domenici-Rivlin Protect Medicare Act (beginning in 2016)	$241	$569	$1,337	$4,906

[20] To promote stability, the proposal calls for employing a five-year historical trend of per-capita GDP rather than measuring the change over a single year.

Bipartisan Policy Center (BPC) Tax Reform
Quick Summary

The BPC Tax Reform Plan represents a radical simplification of the current tax code and would raise approximately $1.3 trillion less than the system under current law. In fact, to best explain it, forget what you know about the complexities of the current tax system, and start fresh. Outlined below are the core elements of the plan:

- A **two-bracket income tax with rates of 15% and 28%**. Because there is no standard deduction or personal exemptions, the 15% rate applies to your 1st dollar of income.[21]

- The **corporate tax rate will be set at 28%**, instead of the current 35% level.

- Capital gains and dividends will be taxed **as ordinary income (with a top rate of 28%)**, excluding the first $1,000 of realized net capital gains (or losses).[22]

- To replace the overly-complex Earned Income Tax Credit (EITC) and to help offset the elimination of personal exemptions, the standard deduction and the child credit, the BPC Plan will establish:
  - A flat **refundable per child tax credit of $1,600** (higher than current law); and
  - A **refundable earnings credit**[23] similar in structure to the recent Making Work Pay credit, but substantially higher.

- Instead of the current system of itemized deductions, which disproportionately subsidizes the housing consumption and charitable giving of upper-income taxpayers, the BPC Plan will:
  - Provide a **flat 15% refundable tax credit for charitable contributions** and for up to $25,000 per year, not indexed, **mortgage interest on a primary residence**.
  - Eliminate the deduction for state and local taxes.
  - Provide a flat, **15% refundable tax credit** or a deduction (for those in the higher bracket) **for contributions to retirement saving accounts** up to 20% of earnings or a maximum of $20,000.

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[21] The 28% rate applies approximately to income above $51,000 for single filers and $102,000 for couples.
[22] $500 for singles and heads of household
[23] The refundable earnings credit is equal to 17.5% of the first $20,000 of earnings.

- Include 100% of Social Security benefits in taxable income, but:
    - Create a non-refundable credit for Social Security beneficiaries equal to 15% of the current standard deduction; and
    - Create a non-refundable credit equal to 15% of an individual's Social Security benefits.

- Effective in 2015, cap and then phase out over 10 years the tax exclusion for employer-sponsored health insurance benefits.

- Allow deduction of medical expenses in excess of 10% of AGI (as in current law).

- Allow deduction of miscellaneous itemized deductions in excess of 5% of AGI.

The BPC Plan achieves a massive simplification of the tax code by **aligning the top individual, capital gains and dividend tax rates, significantly reducing the corporate tax rate, and eliminating the AMT**. Additionally, **most individuals will no longer have to file an annual tax return**[24] beyond an initial declaration of status because the most commonly taken deductions have either been turned into refundable credits, determined solely based on the number of children and earnings, or can only be deducted above a substantial floor. Despite a low top rate of 28%, the new tax system created under the BPC Plan will be **more progressive than the current system** and **raise the requisite revenue to achieve our debt-reduction goal**.

[24] According to Tax Policy Center projections, only 50% of tax units would be required to file tax returns, as opposed to 88% under the current tax system.

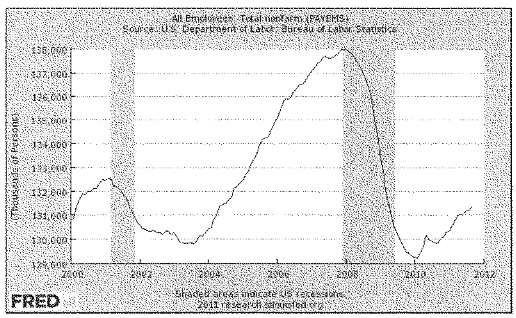
It's Time for a Holiday!

The United States is mired in the slowest recovery from the deepest recession since the Great Depression. Unemployment has hovered around 9 percent for over two years, and there is serious concern about a double dip recession. Any realistic plan to address these problems must garner bipartisan support, and now is the time for action. In order to spur economic growth and business activity, we will need agreement on an effective proposal to boost the flagging economy. The Domenici-Rivlin Task Force's full Social Security payroll tax holiday for calendar year 2012 fits the bill.

The holiday provides much better "bang-for-the-buck" than many other growth measures. It will immediately increase consumer spending and business hiring, thereby providing economic growth and jobs. The tax cut will provide financial relief for roughly 160 million American workers, many of whom are having difficulty making ends meet in the aftermath of the worst recession in nearly a century. A significant portion of the additional take-home pay will be spent quickly by consumers. Some of the money will undoubtedly go towards paying down debt, but household deleveraging is a necessary precondition for a return to low unemployment and sustained growth. A payroll tax holiday will help people get out of debt faster by adding roughly $3,000 to the average worker's paycheck.

The Social Security payroll tax directly funds Social Security. Employees and employers each pay 6.2 percent of salaries – up to a cap of $106,800 per employee – in payroll taxes. Because of this cap, a payroll tax holiday proportionally will direct more money into the pockets of working- and middle-class Americans, those who are most likely to spend it in short order. On the business side, a holiday will reduce the cost of hiring additional workers for every one of America's six million employers, the vast majority of them small business owners.

The Congressional Budget Office (CBO) projects that a full Social Security payroll tax holiday will create between 2.5 and 7 million jobs over two years. With almost 7 million fewer people employed now than before the recession, these jobs are sorely needed. The costs of continued long-term unemployment are steep and likely are already beginning to eat away at our future growth. Long-term unemployment leads to a permanent deterioration of the skills and productivity of our workforce. Therefore, returning unemployed Americans to work as quickly as possible must be a priority.



Temporarily suspending the payroll tax for employees and employers will ***not*** have any net effect on the Social Security Trust Fund. The General Fund of the government will transfer dollar for dollar back to the Trust Fund, such that it is made whole in real time with *no impact* on Social Security's financing.

A payroll tax holiday must be coupled with a strong deficit reduction plan in order to both strengthen the economy and reduce the debt. Restoring the economy to steady growth will help stabilize and reduce the debt, but given the severity of our fiscal imbalance, growth alone is not a panacea. A bold deficit reduction package is necessary, as well.

By providing more money to consumers and business alike right away, however, the payroll tax holiday will help to quickly reignite the struggling economy. It provides more near-term benefits than almost any other proposal in circulation, and will be an effective growth- and job-creator for the United States. That is why the payroll tax holiday is needed now, and should be included in any comprehensive economic recovery plan.

State	# of People Benefiting from Payroll Tax Holiday (millions)	Total Number of Businesses	Total Amount of Payroll Tax Cut (billions of $)
Alabama	2.3	79,812	8.1
Alaska	0.4	16,529	1.7
Arizona	2.9	109,823	11.6
Arkansas	1.4	52,699	4.7
California	16.7	717,133	74.5
Colorado	2.5	130,297	9.9
Connecticut	2	75,842	9.3
Delaware	0.5	20,364	2.3
Florida	9	414,799	33.2
Georgia	4.6	179,576	18.0
Hawaii	0.7	26,360	2.9
Idaho	0.8	39,368	2.9
Illinois	6.5	260,225	27.3
Indiana	3.6	115,466	13.4
Iowa	1.7	65,015	6.4
Kansas	1.6	60,989	5.8
Kentucky	2.1	71,510	7.6
Louisiana	2.1	82,301	7.6
Maine	0.8	34,942	2.3
Maryland	3.1	112,392	15.1
Massachusetts	3.4	141,843	16.3
Michigan	5.1	182,606	19.8
Minnesota	3.1	120,950	13.4
Mississippi	1.4	47,489	4.7
Missouri	3.1	120,145	11.1
Montana	0.6	32,570	1.7

State	# of People Benefiting from Payroll Tax Holiday (millions)	Total Number of Businesses	Total Amount of Payroll Tax Cut (billions of $)
Nebraska	1	42,302	4.1
Nevada	1.2	49,956	4.7
New Hampshire	0.8	32,334	3.5
New Jersey	4.7	202,600	23.8
New Mexico	0.9	37,549	3.5
New York	10.1	443,992	46.0
North Carolina	4.7	176,196	18.0
North Dakota	0.4	17,922	1.2
Ohio	5.7	199,647	20.9
Oklahoma	1.9	73,310	6.4
Oregon	1.9	92,335	7.6
Pennsylvania	6.7	237,055	27.9
Rhode Island	0.6	25,818	2.3
South Carolina	2.2	83,427	8.1
South Dakota	0.5	21,797	1.7
Tennessee	3.2	102,398	11.6
Texas	11.4	396,412	45.4
Utah	1.3	60,271	5.2
Vermont	0.4	19,282	1.7
Virginia	4.3	154,808	19.2
Washington	3.5	150,991	15.7
West Virginia	0.9	30,873	2.9
Wisconsin	3.2	115,003	12.8
Wyoming	0.3	18,104	1.2
United States	158.6	6,095,427	641.0

***Sources:* U.S. Census Bureau, Tax Policy Center, and Center on Budget and Policy Priorities**

BIPARTISAN POLICY CENTER

November 10, 2011

The Honorable Patty Murray
Co-Chair
Joint Select Committee on
Deficit Reduction
448 Russell Senate Office Building
Washington, D.C. 20510

The Honorable Jeb Hensarling
Co-Chair
Joint Select Committee on
Deficit Reduction
129 Cannon House Office Building
Washington, D.C. 20515

Dear Senator Murray and Representative Hensarling:

Thank you for affording us the opportunity to testify before the Joint Select Committee on Deficit Reduction on Tuesday, November 1, regarding the report and recommendations of the Bipartisan Policy Center's Debt Reduction Task Force. We hope that our testimony will be helpful in your difficult but crucial work.

Due to the time restrictions at the hearing we would like to submit a complete response to the questions regarding our tax reform plan and the capital gains exclusion. We hope that this information provides helpful background for the Joint Select Committee as you continue your deliberations and would be grateful if this answer could be included as part of the official record.

As was stated in the hearing, all of the witnesses, and indeed all of the members of the BPC Debt Reduction Task Force, concluded that both increased revenues and outlay cuts will be necessary to contain the nation's rising public debt. Because the Task Force recognized that fact, we spent considerable time developing a fundamental tax reform package, which we believe would meet three essential criteria: increase revenue, stimulate economic growth, and distribute the additional burden according to the ability to pay. To achieve all three goals, we determined that it would be essential to eliminate the current preferential tax treatment of capital gains.

Fortunately, we have a precedent for our recommendation. The Tax Reform Act of 1986, passed by a Republican Senate and a Democratic House and signed by President Ronald Reagan, eliminated the tax preference for capital gains and reduced the top-bracket individual income tax rate to 28 percent. The Task Force proposal is quite similar.

Please allow us to discuss our proposal with respect to capital gains in the context of all three criteria.

Revenue

The evidence shows that the elimination of the capital gains exclusion in the 1986 Act did not significantly reduce sales of assets. In fact, tax revenues on capital gains increased immediately after the effective date of the 1986 Act.

The effect of the 1986 Act on the amount of capital gains realizations involves some nuance.

From the very beginning of the 1986 legislative process, it was clear that the preferential treatment of capital gains would be at least reduced. The prior law provided a 60 percent exclusion for long-term capital gains. The so-called "Treasury I" proposal from the Department to President Reagan eliminated the exclusion in exchange for inflation indexation of the cost basis of assets, which would have increased taxes significantly for comparatively large gains accrued over comparatively short times. The "Treasury II" proposal by President Reagan cut the exclusion to 50 percent. The 1985 House bill cut the exclusion to 42 percent. And then the 1986 Senate bill (which passed the Finance Committee unanimously on May 6), and the conference agreement, eliminated the exclusion entirely.

Throughout this process, the designers of the 1986 Act, including Senate Finance Committee Chairman Bob Packwood and House Ways & Means Committee Chairman Dan Rostenkowski, recognized that the significant reduction in the capital gains preference could raise questions of fair transition. Accordingly, they wrote the law with a prospective effective date (January 1, 1987), so that taxpayers who had contemplated selling an asset using the prior law preference could do so. This created a "fire sale" opportunity for realization of gains at what was in effect a temporarily low rate. Realizations in 1986 were expected to increase substantially, and they did. Revenues from capital gains realized in 1986 were fully double the level of 1985 – the largest increase on record by a factor of two. But that was fully expected and intended to be a one-time phenomenon, as should be obvious from the attached chart.

The open question was what would happen to capital gains tax revenues in 1987, given that many of the gains that were realized in 1986 likely were accelerated from 1987 (and later years) to take advantage of the "fire sale" on the expiring exclusion. Surprising to some, tax receipts on capital gains were higher in 1987 than they were in 1985, the last "normal" year – i.e., without the influence of the transition to taxation of gains as ordinary income – under the prior law. This was true both in dollars and – even more significantly – as a percentage of GDP. In fact, in 1987, tax revenues from capital gains hit the largest percentage in recorded history, discounting the "fire sale" year of 1986 – and then were superseded immediately by a new record tax revenue year in 1988. This result was remarkable, especially in light of the likely acceleration of the realization of significant amounts of gains from 1987 and 1988 forward to 1986 because of the temporary tax advantage to do so.

Subsequent years confirmed that the 1986 Act was conducive to revenue growth from realizations of capital gains. The treatment of capital gains remained essentially unchanged through 1996. Between 1987 and 1996, after a decline because of the 1990-1991 recession, tax revenues from capital gains increased as a share of the GDP, and doubled in dollar terms. The 1996 ratio displaced that of 1988 as the highest "normal" year on record, not that far below the 1986 "fire sale" year. And overall tax revenue was growing with the economy, combining with spending restraint to narrow the previously troublesome budget deficit from the then-record level of $290 billion (4.7 percent of GDP) in 1992 to only $107 billion (1.4 percent of GDP) in 1996. In that period, federal revenues had increased from 17.5 percent to 18.8 percent of GDP, while outlays had declined from 22.1 to 20.2 percent of GDP, contributing to the reduction in the deficit.

We believe that the simple amount of tax revenue on capital gains realizations actually understates the federal government's revenue gain from 1986-style tax reform. Under the BPC proposal, the top-bracket tax rates for ordinary income, capital gains, and corporate income all will be equal. There will no longer be a reward for legal manipulation to re-characterize ordinary income as capital gain, capital loss as ordinary loss, or an individual business as a corporate business (or vice versa). The manipulation between capital and ordinary gain or loss has been widely cited as by far the greatest source of actual day-to-day tax complexity. Such manipulation also, obviously, reduces tax revenue. Even economic growth can suffer, as labor and investment capital are moved from their best uses in the free marketplace to their best uses on the tax form. True tax reform, such as the Task Force proposal, would increase revenues in part merely by ending such manipulation. The portion of the 1986 Act that ended such manipulation ***increased*** total revenues, but ***decreased*** measured revenue from the taxation of capital gains. This fact makes the rise in capital gains revenues from the 1986 experience even more striking: the revenues rose more than enough to fully offset the measured negative effect of cracking down on manipulation.

Economic Growth

Experience has demonstrated that the 1986 Act was conducive not only to revenue growth, but also to economic growth. By 1996, under essentially the same capital gains tax treatment as in the 1986 Act, the economy had recovered from the 1990-1991 recession, economic growth was robust, and a full-fledged investment boom was underway. Business investment in equipment, which had fallen to 6.9 percent of the GDP in the 1990-1991 recession, was up to 8.3 percent in 1996. Real GDP grew by an average of 3.3 percent over 1992-1996, and 3.7 percent in 1996.

This result follows from basic economics. Economists know that the income tax on capital gains is a very small part of the cost of capital. Far greater is the cost of funds – the interest rate itself. The main mission of the Joint Select Committee – deficit reduction – is far more important for capital investment than anything that might be done to protect the tax preference for capital gains.

Capital gains tax preferences are also much more a bonus for the already-wealthy portfolio investor than an incentive for the budding entrepreneur. The capital gains tax preference is irrelevant for the many entrepreneurs who hope to build and run successful businesses and earn salaries from them. Even for such entrepreneurs who look forward eventually to selling their businesses upon retirement, the capital gains tax is years away, and its impact on their ultimate outcomes will be overwhelmed by the degree of their success in running their businesses.

The much greater part of capital gains realized by individuals is on sales of corporate stock by portfolio investors, rather than sales of businesses owned by entrepreneurs. In the latest (2007) data released by the Internal Revenue Service, tax-favored long-term capital gain or loss transactions on corporate stock accounted for 53 percent of all transactions, and 26 percent of all net capital gain. In stark contrast, capital gain or loss transactions on partnership, S corporation and estate or trust interests accounted for only 2 percent of all transactions, and less than 6 percent of all net capital gain – only about one-fifth the amount of sales of shares of established corporations. Net ordinary income from businesses and professions was nearly seven times the amount of capital gains from sales of businesses – and that does not include any of the entrepreneurial income that is reported as simple salary income. And of course, a tax preference afforded to all capital gains steers scarce resources also to all other kinds of investments – including precious metals, collectibles, U.S. government bonds, and so on – instead of to the rewards to true entrepreneurs, much of which flow in the form of ordinary income.

As noted earlier, a lower tax rate for capital gains directs more capital into investments that are more likely to throw off income as capital gains, at the expense of some other uses that might actually have higher rates of return. Capital gains treatment historically has been one of the key ingredients in the classic tax shelter, which wastes society's scarce resources on investments that generate tax losses to offset other income, rather than profits earned in the free marketplace. And misleadingly, because the eventual cash receipts from liquidating tax shelters are reported as realized capital gains, this sheer economic waste makes the tax receipts from capital gains look larger.

The Task Force proposal includes a substantial reduction in the corporate income tax rate, to 28 percent. That makes the corporate rate approximately equal to the average across all developed nations. Because firms usually want to locate in the markets in which they sell, and because the United States is the largest market in the world, this competitive corporate tax rate should encourage the location of more production activity in the United States, with resulting benefits for employment. And the reduction of the tax rate for corporate-source income will provide a benefit to owners of corporate stock who would lose the capital gains preference.

In sum, we believe that the Task Force tax proposal would on net be more conducive to economic growth than the current system, while also reducing the deficit directly.

Fairness

The capital gains preference is a key reason why many people of extraordinary wealth can pay lower tax rates on their income, at the margin, than people of far more modest means who simply work for a living.

Because capital gains are such an important source of income for those at the top of the income scale, this tax preference has great leverage over the distributional results that are used to judge the progressivity and fairness of the tax system. More than three quarters (78.5 percent) of all tax returns with adjusted gross income (AGI) of over $1 million report tax-preferred long-term capital gains income, and on average those capital gains equal almost two fifths (39.0 percent) of the amount of their AGI. (Of returns with over $10 million of income, 92.8 percent have tax-preferred gains, equal to 52.1 percent of their AGI.) In stark contrast, of the income group ($30,000 to $40,000) of the median taxpayer, only 5.2 percent have any tax-preferred capital gains, constituting only 0.9 percent of their total income. Accordingly, if there is a capital gains preference in an alternative tax system as part of budget deficit reduction, the larger that preference, the higher must be the tax rate on ordinary income. In other words, we cannot have lower capital gains tax rates for free; they must be offset by higher tax rates on ordinary income. But increasing the capital gains preference and increasing the tax rate on ordinary income explicitly transfers income from people who work – including many job-creating entrepreneurs – to people who already have accumulated wealth. That such an outcome should be perceived as fair is far from clear, not to mention the economically distorting effects of the higher ordinary-income tax rate.

Conclusion

In an uncertain world with complex issues at play, the tax reform proposal of the BPC Debt Reduction Task Force provides the best balance that we have found among the nation's revenue needs, the imperative of economic growth, and society's need for a foundation of fairness of contribution according to ability to pay.

The objection that we hear most often to the elimination of any tax preference, with the capital gains preference perhaps the most prominently cited, is that it will inhibit economic growth. We refer those who bear that concern to a column by Martin S. Feldstein in the *Wall Street Journal* of October 24, 2011, in which he estimates significant increases in taxable income as the result of the enactment of the Tax Reform Act of 1986. The Tax Reform Act of 1986, as you know, eliminated the tax preference for capital gains. We can only conclude that there is perhaps a broader than realized consensus among economists – not to mention the endorsement of President Ronald Reagan – that the capital gains preference is not essential for economic growth, and does not increase tax revenues.

Again, thank you for the opportunity to testify. We hope that you find this expanded response helpful to you.

Sincerely,

Pete V. Domenici

Senator Pete Domenici

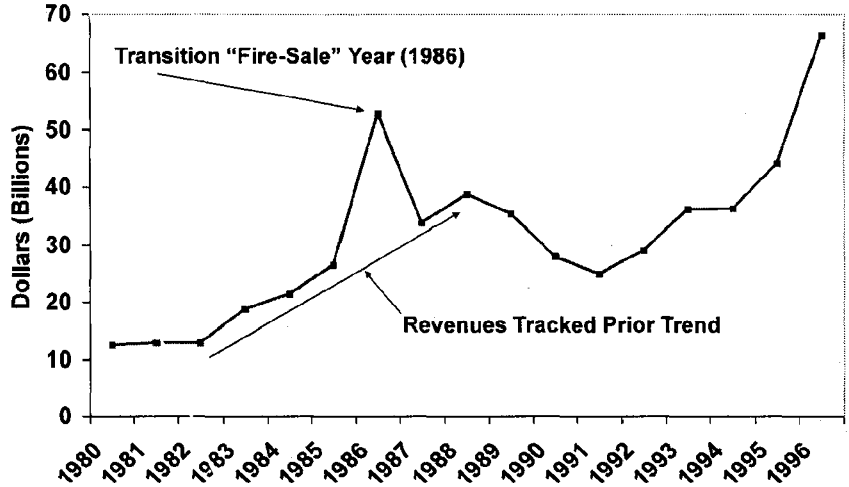
Alice M. Rivlin

Alice M. Rivlin

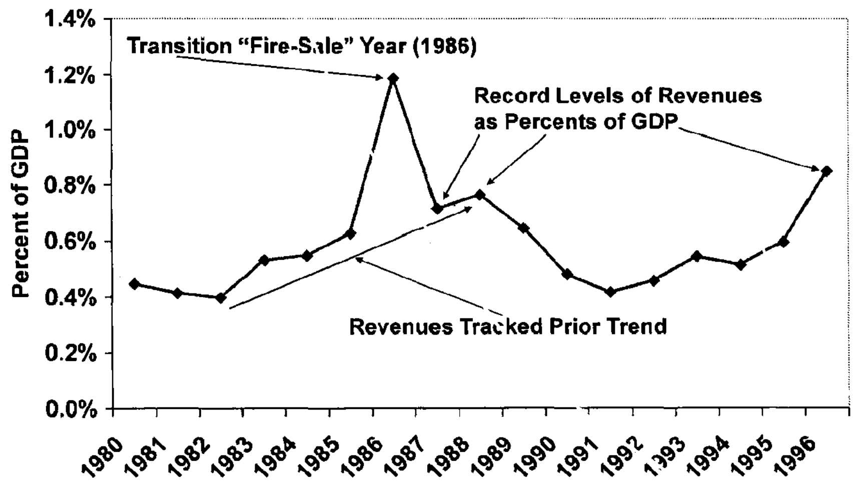
Year	Total Realized Capital Gains	Taxes Paid on Capital Gains	Average Effective Rate	Taxes Paid as a Percent of GDP	Maximum Tax Rate on Long Term Gains
1954	7,157	1,010	14.1	0.27%	25.00
1955	9,881	1,465	14.8	0.35%	25.00
1956	9,683	1,402	14.5	0.32%	25.00
1957	8,110	1,115	13.7	0.24%	25.00
1958	9,440	1,309	13.9	0.28%	25.00
1959	13,137	1,920	14.6	0.38%	25.00
1960	11,747	1,687	14.4	0.32%	25.00
1961	16,001	2,481	15.5	0.46%	25.00
1962	13,451	1,954	14.5	0.33%	25.00
1963	14,579	2,143	14.7	0.35%	25.00
1964	17,431	2,482	14.2	0.37%	25.00
1965	21,484	3,003	14.0	0.42%	25.00
1966	21,348	2,905	13.6	0.37%	25.00
1967	27,535	4,112	14.9	0.49%	25.00
1968	35,607	5,943	16.7	0.65%	26.90
1969	31,439	5,275	16.8	0.54%	27.50
1970	20,848	3,161	15.2	0.30%	32.21
1971	28,341	4,350	15.3	0.39%	34.25
1972	35,869	5,708	15.9	0.46%	36.50
1973	35,757	5,366	15.0	0.39%	36.50
1974	30,217	4,253	14.1	0.28%	36.50
1975	30,903	4,534	14.7	0.28%	36.50
1976	39,492	6,621	16.8	0.36%	39.88
1977	45,338	8,232	18.2	0.41%	39.88

1978	50,526	9,104	18.0	0.40%	39.875/33.85
1979	73,443	11,753	16.0	0.46%	28.00
1980	74,132	12,459	16.8	0.45%	28.00
1981	80,938	12,852	15.9	0.41%	28.00/20.00
1982	90,153	12,900	14.3	0.40%	20.00
1983	122,773	18,700	15.2	0.53%	20.00
1984	140,500	21,453	15.3	0.55%	20.00
1985	171,985	26,460	15.4	0.63%	20.00
1986	327,725	52,914	16.1	1.19%	20.00
1987	148,449	33,714	22.7	0.71%	28.00
1988	162,592	38,866	23.9	0.76%	28.00
1989	154,040	35,258	22.9	0.64%	28.00
1990	123,783	27,829	22.5	0.48%	28.00
1991	111,592	24,903	22.3	0.42%	28.93
1992	126,692	28,983	22.9	0.46%	28.93
1993	152,259	36,112	23.7	0.54%	29.19
1994	152,727	36,243	23.7	0.51%	29.19
1995	180,130	44,254	24.6	0.60%	29.19
1996	260,696	66,396	25.5	0.85%	29.19
1997	364,829	79,305	21.7	0.95%	29.19/21.19
1998	455,223	89,069	19.6	1.01%	21.19
1999	552,608	111,821	20.2	1.20%	21.19
2000	644,285	127,297	19.8	1.28%	21.19
2001	349,441	65,668	18.8	0.64%	21.17
2002	268,615	49,122	18.3	0.46%	21.16
2003	323,306	51,340	15.9	0.46%	21.05/16.05
2004	499,154	73,213	14.7	0.62%	16.05
2005	690,152	102,174	14.8	0.81%	16.05
2006	798,214	117,793	14.8	0.88%	15.70
2007	924,164	137,141	14.8	0.98%	15.70
2008	497,841	68,791	13.8	0.48%	15.35

Capital Gains Tax Revenues Grew After 1986 Act



Capital Gains Tax Revenues Grew After 1986 Act



Representative Jeb Hensarling

Co-Chair, Joint Select Committee on Deficit Reduction

"What I do believe we will hear from each of our witnesses is that America at least does indeed face a legitimate debt crisis. Not only are we operating on borrowed money, we are operating on borrowed time as well. In that vein, I never tire of reminding not only myself but the public and my colleagues that although we have a statutory goal to reduce the growth of the deficit over ten years by $1.5 trillion, backed up by a $1.2 trillion sequester should we fail, more importantly we have a statutory duty to proffer legislation that would significantly improve the nation's long term fiscal balance.

"What could not be clearer is that unless we offer fundamental and structural reforms to our nation's entitlement programs, especially health care, we will not only end up failing in our duty, we may fail our nation as well. Health care costs measured by GDP roughly have doubled since the time of my birth until I entered the workforce and have risen about two-thirds since then, and are growing at what all acknowledge to be an unsustainable rate. Every agency and think tank I am aware of, every academic study, shows that Medicare will go broke in 9-13 years.

"The president himself has said that, "the major driver of our long term liabilities, everybody here knows it, are Medicare and Medicaid, and our healthcare spending, nothing comes close." I continue to agree with the president. Unfortunately, Social Security faces its problems as well, my children will likely put more money into Social Security than they take out; at best generational unfairness, at worst a form of generational theft.

"We have previously heard from the Congressional Budget Office that tax revenues upon the recovery of this economy will once again produce roughly 18.5 percent of GDP, we also know that there are many tax increases already built into current law. But spending, principally driven by our health care and retirement programs, is due to roughly double in size to 40 percent of GDP over the course of a generation from where it was just a few short years ago.

"Certainly we cannot tax our way out of this crisis, we cannot solve it by simply tinkering around the edges of our entitlement programs. For the sake of our economy, our jobs, our national security, and our children's future, many people say it is time to "go big" I agree, but "going big" is not merely measured by slowing the rate of growth of the deficit over the next ten years. "Going big" must be measured in solving the problem—in other words, fundamental and structural reforms of our entitlement programs, giving every American the opportunity for quality healthcare and quality retirement security at a cost that does not harm our jobs and diminish our children's future."

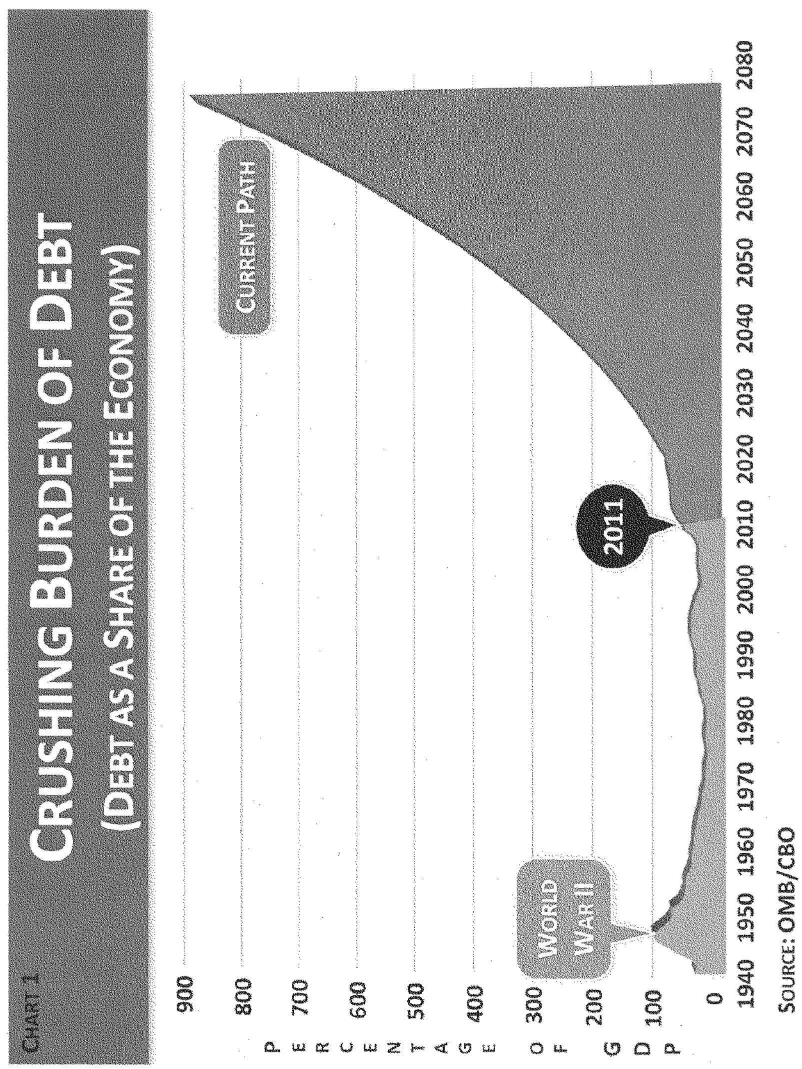


CHART 1
CRUSHING BURDEN OF DEBT
(DEBT AS A SHARE OF THE ECONOMY)
PERCENTAGE OF GDP
900
800
700
600
500
400
300
200
100
0
1940 1950 1960 1970 1980 1990 2000 2010 2020 2030 2040 2050 2060 2070 2080
CURRENT PATH
2011
WORLD WAR II
SOURCE: OMB/CBO

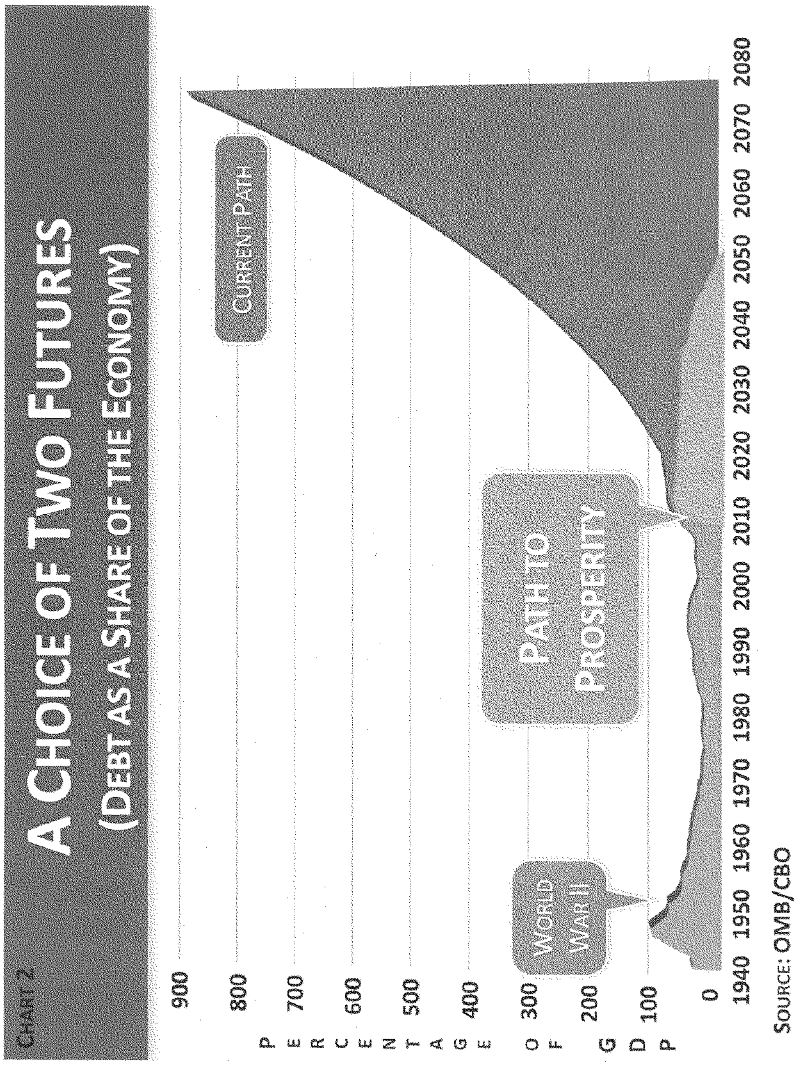


CHART 2
A CHOICE OF TWO FUTURES
(DEBT AS A SHARE OF THE ECONOMY)
CURRENT PATH
PATH TO PROSPERITY
WORLD WAR II
PERCENTAGE OF GDP
0
100
200
300
400
500
600
700
800
900
1940 1950 1960 1970 1980 1990 2000 2010 2020 2030 2040 2050 2060 2070 2080
SOURCE: OMB/CBO

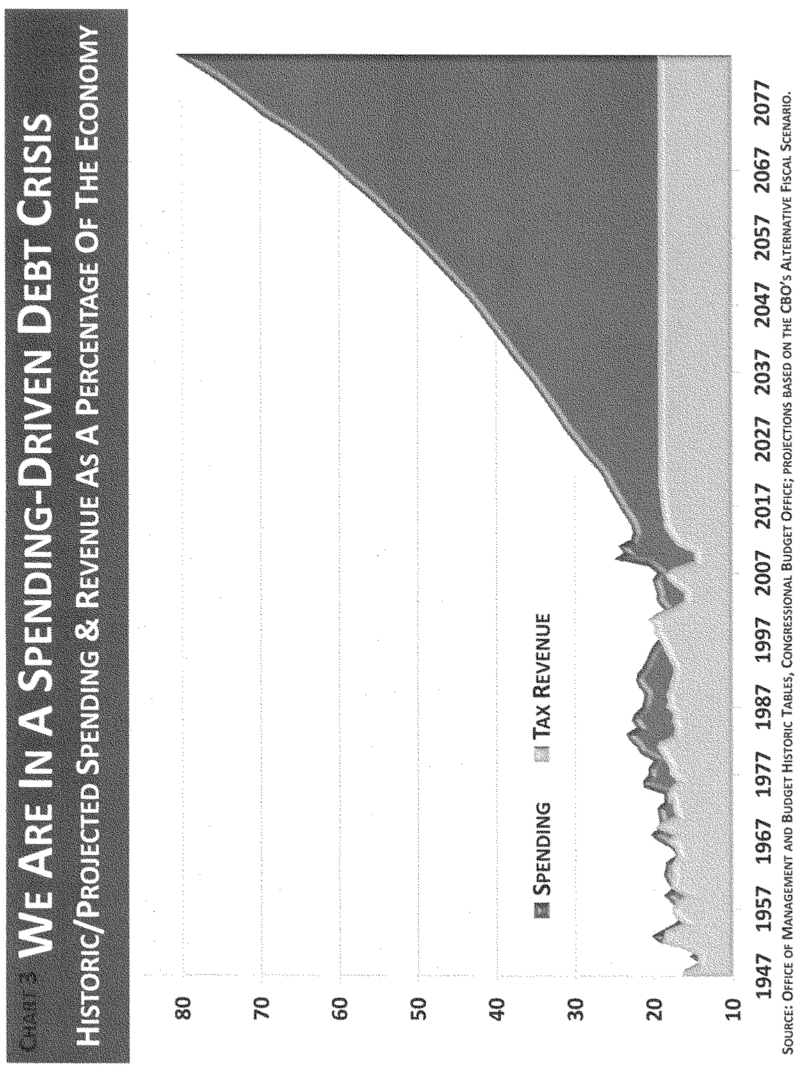


CHART 3 WE ARE IN A SPENDING-DRIVEN DEBT CRISIS
HISTORIC/PROJECTED SPENDING & REVENUE AS A PERCENTAGE OF THE ECONOMY
80
70
60
50
40
30
20
10
SPENDING
TAX REVENUE
1947 1957 1967 1977 1987 1997 2007 2017 2027 2037 2047 2057 2067 2077
SOURCE: OFFICE OF MANAGEMENT AND BUDGET HISTORIC TABLES, CONGRESSIONAL BUDGET OFFICE; PROJECTIONS BASED ON THE CBO'S ALTERNATIVE FISCAL SCENARIO.

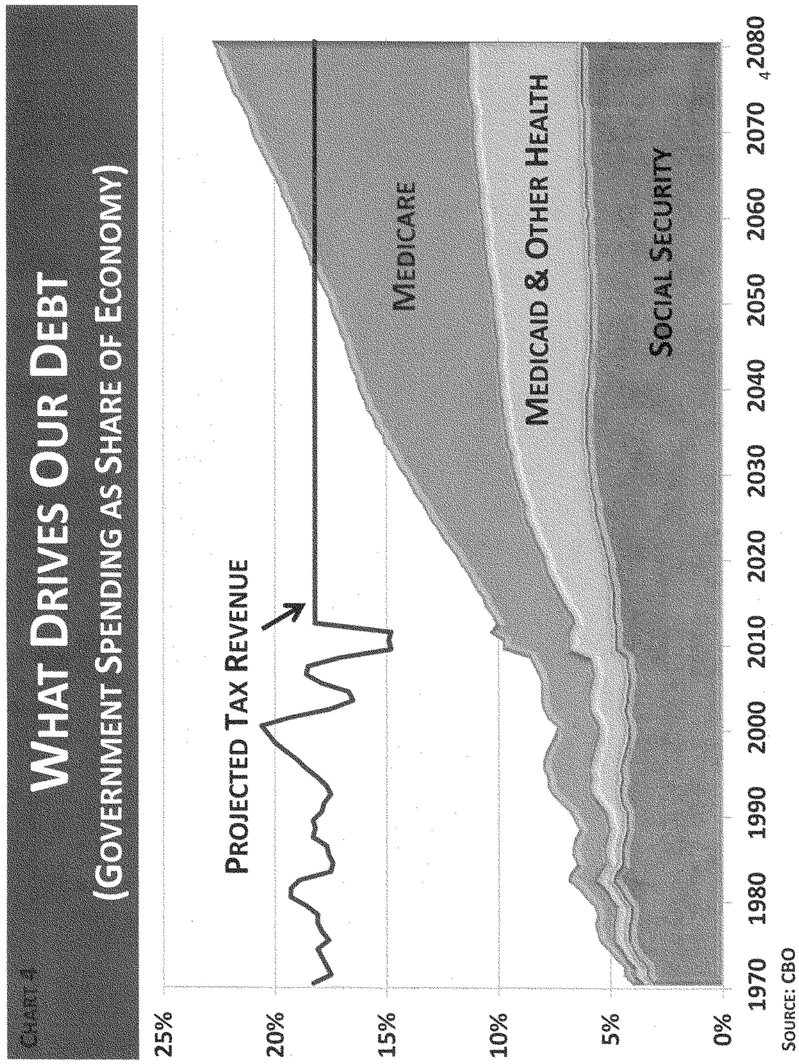


CHART 4
WHAT DRIVES OUR DEBT
(GOVERNMENT SPENDING AS SHARE OF ECONOMY)
25%
20%
15%
10%
5%
0%
PROJECTED TAX REVENUE
MEDICARE
MEDICAID & OTHER HEALTH
SOCIAL SECURITY
1970
1980
1990
2000
2010
2020
2030
2040
2050
2060
2070
2080
SOURCE: CBO

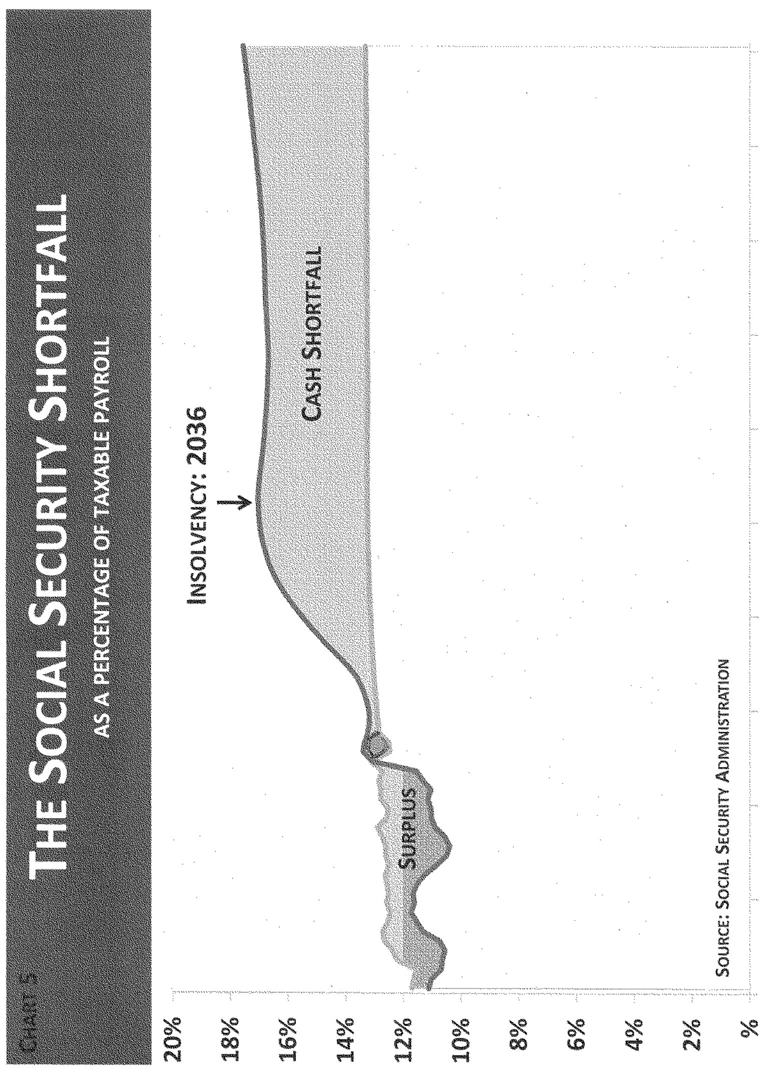


CHART 5
THE SOCIAL SECURITY SHORTFALL
AS A PERCENTAGE OF TAXABLE PAYROLL
INSOLVENCY: 2036
CASH SHORTFALL
SURPLUS
SOURCE: SOCIAL SECURITY ADMINISTRATION
20%
18%
16%
14%
12%
10%
8%
6%
4%
2%
%
1985
1995
2005
2015
2025
2035
2045
2055
2065
2075
2085

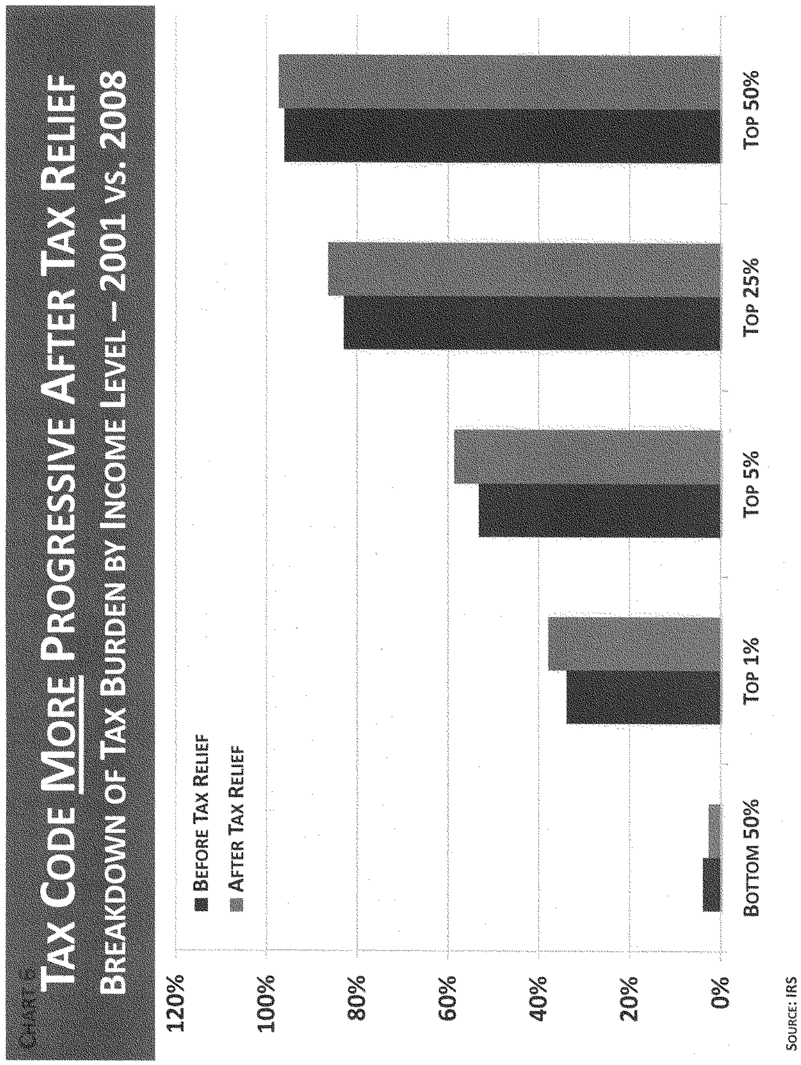


CHART 6
TAX CODE MORE PROGRESSIVE AFTER TAX RELIEF
BREAKDOWN OF TAX BURDEN BY INCOME LEVEL – 2001 VS. 2008
BEFORE TAX RELIEF
AFTER TAX RELIEF
120%
100%
80%
60%
40%
20%
0%
BOTTOM 50%
TOP 1%
TOP 5%
TOP 25%
TOP 50%
SOURCE: IRS

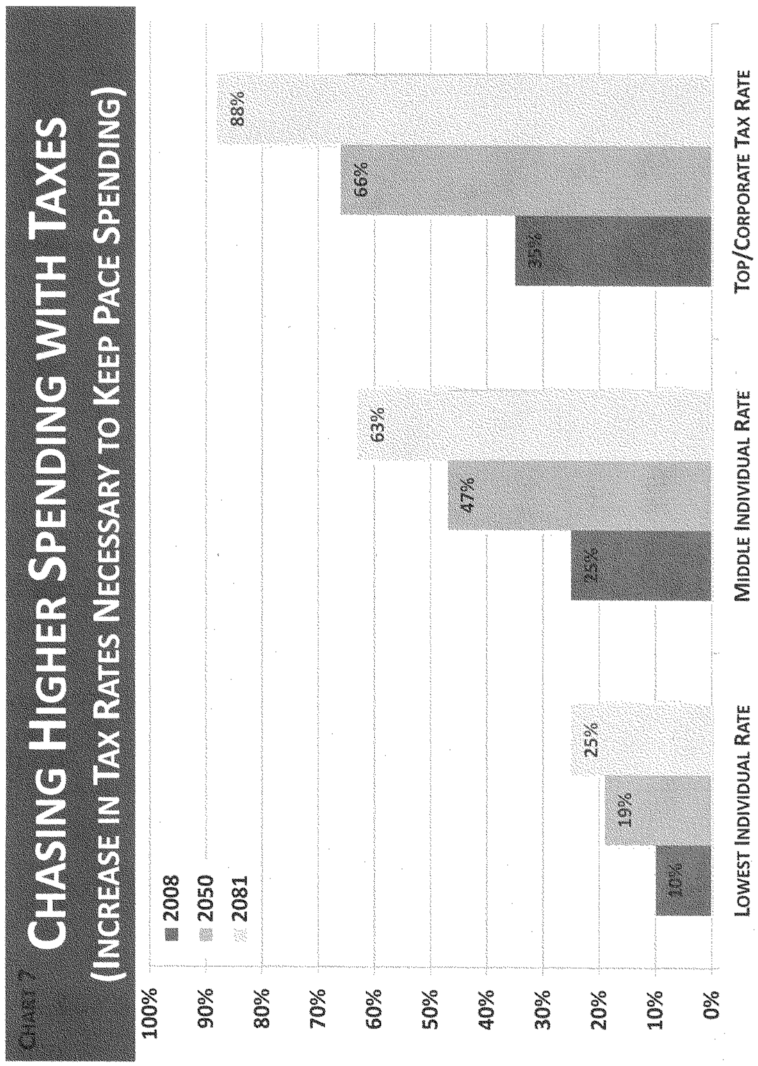
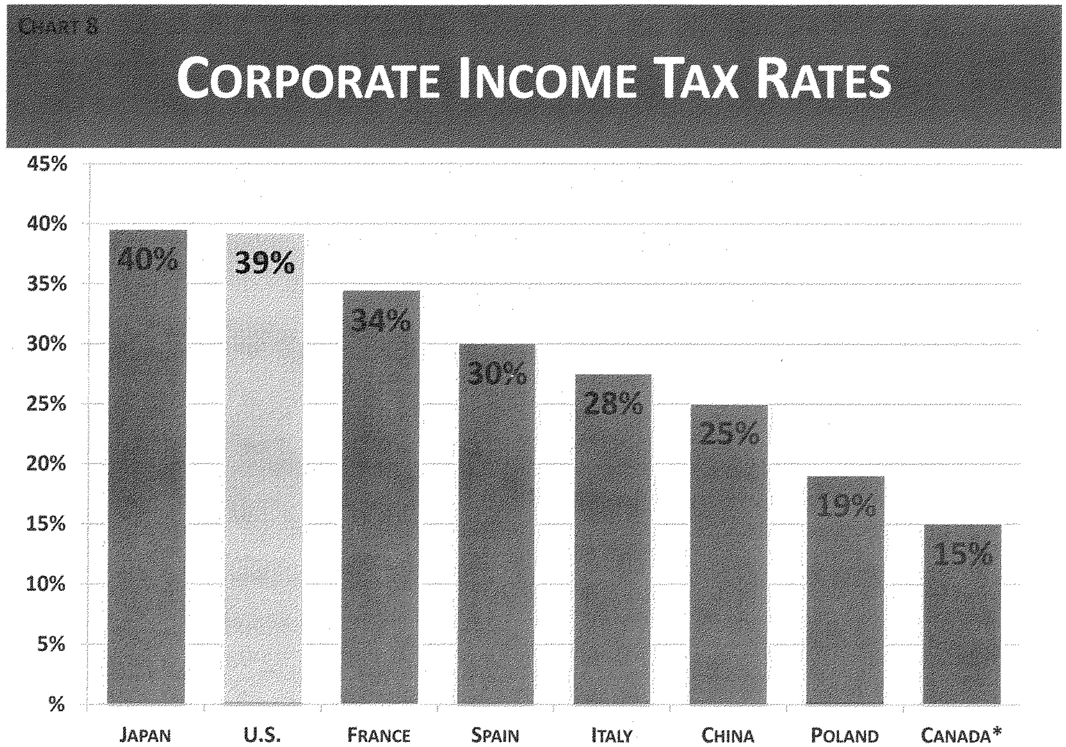


CHART 7
CHASING HIGHER SPENDING WITH TAXES
(INCREASE IN TAX RATES NECESSARY TO KEEP PACE SPENDING)
2008
2050
2081
100%
90%
80%
70%
60%
50%
40%
30%
20%
10%
0%
10%
19%
25%
25%
47%
63%
35%
66%
88%
LOWEST INDIVIDUAL RATE
MIDDLE INDIVIDUAL RATE
TOP/CORPORATE TAX RATE

SOURCE: CBO



SOURCE: ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

*=CANADA 'S CORPORATE TAX RATE WILL DROP TO 15% IN JANUARY 2012

8

Senator Patty Murray

Co-Chair, Joint Select Committee on Deficit Reduction

"Thank you Representative Hensarling. And I want to thank all of my colleagues, our witnesses, and members of the public joining us today.

"We have been working hard together for the past two months, but with twenty three days left to go until our deadline, and with even less time before we need to have a plan ready to be voted on—we are now entering the critical final phase of this process.

"And as we all know, the consequences of failure are unacceptable. The triggers that have been put in place would be devastating for our national defense and for middle class families and the most vulnerable Americans who depend on education, housing, and nutrition assistance for women and infants.

"Markets, ratings agencies, and businesses across the country are watching closely to see if Congress can solve this problem.

"And the American people are looking to us to break out of the gridlock and partisan rancor that has dominated DC recently, and to deliver the kind of results they expect and deserve.

"That's why members of this Committee have been clear: we need to find a way to come together around a bipartisan deal.

"So I believe it's very appropriate that we are having this hearing, with these witnesses, as we move into the final few weeks.

"Before us we have Democrats and Republicans who were able to come together around big and balanced proposals that tackle some of the most difficult challenges facing our nation.

"The two groups went about it in slightly different ways, and I don't agree with every piece of each plan—but they provide serious models for big and balanced bipartisan proposals.

"And as I know we will hear more about today—these proposals achieved bipartisan support and came together only because they were balanced, they included concessions from all sides, and they required all Americans to share in the sacrifices that this endeavor calls for.

"Neither of these bipartisan proposals included only spending cuts, and they didn't simply address entitlements—or only raise revenue.

"They put everything on the table, they made the tough decisions—and because of that, they were able to put together balanced packages that garnered bipartisan support.

"So as this committee moves into the home stretch, hearing more about the importance of a balanced approach is going to be very helpful. Because as our witnesses today can address—a bipartisan deal isn't possible if members refuse to come out from their partisan or ideological corners.

"It's not enough for either side to simply say they want to reduce the deficit—now is the time when everyone needs to be putting some real skin in the game and offering serious compromises.

"Democrats have made clear we are prepared to do that. We've said we are very open to painful concessions and compromises if Republicans are as well—and we have put forward serious ideas that reflect this.

"But these concessions would only be made—and only considered—in the context of a balanced deal that doesn't just fall on the middle class and most vulnerable Americans—but that requires big corporations and the wealthiest among us to share in the sacrifices.

"The American people realize this. They overwhelmingly support a balanced approach.

"Which is why this is the kind of deal every bipartisan group that has successfully tackled this issue has made—it's the kind of deal I am looking forward to hearing more about from our witnesses today—and it's the kind of deal I am hopeful every member of this committee is prepared to make.

"So again, I want to thank our witnesses for being here with us today to have this critical conversation. The bipartisan, balanced work you've done provides a strong foundation for this committee. And I look forward to hearing your testimony and asking some questions."

Score of PPACA: 2014-2023*

Effects on the Federal Deficit	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2014-2023
Medicaid & CHIP Outlays /c	30	55	77	84	87	93	97	105	113	121	861
Exchange Subsidies & Related Spending /d,e	23	55	87	104	115	123	130	137	144	151	1068
Small Employer Tax Credits /f	7	8	5	2	2	2	2	2	2	2	35
Gross Cost of Coverage Provisions	60	118	169	189	204	218	229	245	259	274	

1.964 Trillion

***Figures for 2022 and 2023 based on conservative committee estimates of the growth in PPACA spending
***Figures do not include potential higher costs of the increased Medicaid woodworking effect
***Figured do not include potential higher costs of Exchange subsidies due to increased employer drop rate